Vol. VIII

TRANSCRIPT OF RECORD

(Pages 3537 to 4056)

Supreme Court of the United States

OCTOBER TERM, 1944

No. 296

PANHANDLE EASTERN PIPE LINE COMPANY, ILLINOIS NATURAL GAS COMPANY AND MICHIGAN GAS TRANSMISSION CORPORATION, PETITIONERS,

vs.

FEDERAL POWER COMMISSION, CITY OF DETROIT, COUNTY OF WAYNE, MICHIGAN, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 28, 1944.

CERTIORARI GRANTED JANUARY 3, 1945.

VOL. VIII.

TRANSCRIPT OF RECORD.

United States Circuit Court of Appeals
EIGHTH CIRCUIT.

No. 12,466

PANHANDLE EASTERN PIPE LINE COMPANY, A CORPORATION, ILLINOIS NATURAL GAS COMPANY, A CORPORATION, AND MICHIGAN GAS TRANSMISSION CORPORATION, A CORPORATION, PETITIONERS,

vs.

FEDERAL POWER COMMISSION, CITY OF DETROIT, MICHIGAN, COUNTY OF WAYNE, MICHIGAN, MICHIGAN CONSOLIDATED GAS COMPANY, A CORPORATION, AND MICHIGAN PUBLIC SERVICE COMMISSION, RESPONDENTS.

PETITION TO REVIEW AND SET ASIDE ORDER OF FEDERAL POWER COMMISSION

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FILED FEBRUARY 6, 1943.

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The well lines, gathering lines, and trunk lines, in Texas, Oklahoma, and Kansas, will require 29,805 tons, giving a total tonnage of pipe required of 59,127 tons.

Q. Now, even if you had that pipe and the compressor stations which you have listed, would you still feel safe in operating the system with a continuous daily de-[fol. 9791] livery of 338 million, without further equipment?

A. That would depend largely on the load factor.

Q. Assuming a 90 per cent load factor?

A. Assuming a 90 per cent load factor it would be practically impossible to operate the compressor stations without a standby unit in each station.

Q. Why is that true?

A. Because it is necessary to repair these units as well as to operate them.

It takes from two to three weeks to repair one of these large engines, and a repair or maintenance job is required after about 4,000 hours of operation.

There are roughly some 8,000 hours in a year, so it would indicate at 90 per cent load factor that these units—one unit would be under a repair operation almost all the time at a 90 percent load factor rating.

Q. What is your practice as to these repairs under the load factor which has heretofore applied?

A. We are able, on the present basis, to repair all of our units during the summer period.

Since our load factor is in the order of 65 to 70 per cent this would indicate that, during the summer, only part of the units in each station is running, giving us a spare, or sometimes two spares, to work on during the slack period.

Q. Then if there was continuous operation on a load [fol. 9792] factor of 90 per cent, what additional capital expenditures would be required for safe operation and dependable operation?

A. The Michigan Gas Transmission Corporation would be required to install an additional compressor unit in each

of its three compressor stations, the total cost of which would be $520,000.

Panhandle Eastern Pipe Line Company would be required to put a new unit or standby unit in each of its compressor stations.

I have included only compressor stations from Liberal eastward, trusting that the field stations would not require a standby unit for the proper maintenance of these stations.

In other words, the flexibility in the field is sufficient to permit the repair of an occasional unit in the field.

Panhandle Eastern's expenditure on this basis would be $1,407,000, making a total of $1,927,000 to be invested in standby units.

Q. Is that study of standby compressors reflected on your exhibit 230?

A. It is, on page 5.

Q. Then, in order to have a continuous daily delivery capacity of 338,000 M.c.f. at 90 per cent capacity factor, and in order to feel safe in the view that you could furnish [fol. 9793] that much every day, it would be required to make that expenditure, in addition to the expenditures for compressor stations and loop lines, which are shown in your exhibit 230?

A. That is correct.

Q. Now will you explain Exhibit 231?

A. 231 follows very closely Mr. Hinton's exhibit No. 224.

In other words, I have carried the computations, and so forth, eastward from Louisburg, with some duplications in the field, as will be explained later.

A minimum amount of steel is to be used in bringing about the same answer as was obtained on Exhibit No. 230, and in reducing this quantity of steel we have assumed that there will be no looping of the trunk gathering line extending up from the Panhandle field to Liberal station.

This gas, which we formerly contemplated would come from Texas and Oklahoma, will come from Kansas.

Q. That is, the greater portion of it will come from Kansas?

A. That is correct.

Q. All right.

A. Therefore, power or compressor stations are to be installed in the Hugoton field. These two compressor stations are—

[fol. 9794] Mr. Littman (interposing) Just a minute. You say "will be." You mean: based on certain assumptions?

The Witness: Yes, sir.

Mr. Littman: If this, that, or the other thing happens?

The Witness: That is correct.

A. (Continuing) These compressor stations are reflected in Mr. Hinton's exhibit No. 224, as well as in my exhibit No. 231.

The same quantity of gas, it is assumed, will be handled on the maximum day.

By Mr. Colton:

Q. What about the compressor station equipment which will be required on the main line, including the Michigan Gas Transmission?

Is there any difference in that?

A. Inasmuch as the quantity of gas to be handled on the maximum day is the same, there is no change in that connection.

Q. How about the looping?

A. The looping is the same.

Q. In other words there is no change between Exhibit 230 and 231, except in so far as the field is concerned?

A. With another exception, and that concerns the telephone lines east of Louisburg, Kansas. We have eliminated those also, in line with cutting down on materials and ex-
[fol. 9795] penditures.

Q. With the idea of using what facilities for that?

A. Using the private commercial lines for those facilities.

Q. Such as you are now using?

A. That is correct.

Q. The Hugoton and Satanta plants shown in your exhibit 231 are those about which Mr. Hinton testified?

A. That is correct.

Q. Now, did you make a study as to the volumes of pipe required under the plan set out in Exhibits 231 and [231]?

A. The quantity of pipe required in the event we build these two compressor stations in western Kansas, instead of pipe lines in the field, is very much less than that required on the basis that we would bring a considerable quantity of gas up from Texas.

Q. It is the difference between 59,127 tons and 29,824 tons, is it not? A. That is correct.

Q. So that this study presented in exhibit 231 reflects only approximately half the amount of tonnage required as was required under exhibit 230?

A. That is right.

Q. And what would be the total investment, exclusive of standby compressor units, gas wells, and other field [fol. 9796] costs required under exhibit 230?

A. $11,542,537.

Q. And what would be the total investment exclusive of standby compressor units, gas wells, and other field costs required under exhibit 231?

A. The total investment, exclusive of standby compressor units, gas wells, and other field costs, is estimated to be $8,324,534.

Q. Do the same observations with respect to standby units apply to that study as apply to exhibit 230?

A. They do.

Q. Now, will you explain exhibit 229?

A. Exhibit 229 was developed in response to a request to determine how much gas could be delivered on the maximum day with the same looping as was involved in exhibits 230 and 231 but with no compressor additions whatever except as standby units might be required in each of the compressor stations from Liberal eastward.

The maximum capacity which could be delivered on that basis, on a continuous daily basis, is 307 million cubic feet, as compared with the 338 million cubic feet per day in Exhibits 230 and 231?

Q. You used the same looping in all three of those exhibits, is that correct?

A. That is correct. The same looping east from Lib-
[fol. 9797] eral station.

Q. And you used the same capital investment for compressor additions in all three exhibits for standby capacity?

A. No; I made some change.

Q. All right. What was the change?

A. I have recognized the fact in Exhibit No. 229 that when a standby unit is built or installed by itself and not in conjunction with other power, that the cost will be slightly increased.

Q. And is that difference in cost reflected on page 5?

A. It is.

Q. Of Exhibit 229?

A. That is correct.

Q. I believe you stated that the same tonnage would be required under exhibit 229, same steel tonnage, as would be required under exhibit 231?

A. That is correct.

Q. And that by increasing the units in the compressor stations you could increase the daily delivery capacity from 307 million to 338 million?

A. That is right.

Mr. Culton: You may take the witness.

Cross-Examination.

By Mr. Littman:

Q. By "steel tonnage" you mean pipe tonnage, do you
[fol. 9798] not? A. That is correct.

Q. Mr. Burnham, with respect to Exhibit No. 230, that might be characterized, might it not, as a pipe dream under conditions as they exist today, might it not?

A. Well, you (Mr. Littman) might characterize it as that, but we don't know how important the W. P. B. might feel that it is essential that Panhandle Eastern Pipe Line Company do certain things in a certain way.

Q. You can't get the pipe, can you?

A. We might get the pipe.

Q. In other words you have presented these three studies because you don't, at this writing, know in which manner you may be required to operate your system to meet certain requirements?

A. That is exactly right.

Q. But you submitted a study heretofore—Exhibit 47—which set forth your best judgment of the most economical manner in which to operate the property, or in which to expand the property, did you not?

A. Yes, that is true, and it checks very closely with this figure here.

I think that at that time I arrived at an economic maximum capacity of 331 million. We now have 338 million which is a result of recasting our figures and balancing [fol. 9799] the system somewhat in better form—

Mr. Culton: (interposing) That is, as a result of taking over the Michigan Gas Transmission Corporation—did that help you to balance the system?

The Witness: Yes. We balanced by throwing in a little more power in at Tuscola and less power at Montezuma.

* * * * * * * * * *

[fol. 9810] C. H. M. Burnham having been heretofore duly sworn, resumed the stand and was further examined and testified as follows:

Cross-Examination (Resumed)

By Mr. Littman:

Q. Mr. Burnham, referring to Exhibit No. 229 which shows your estimate of the capital additions required to increase the continuous daily delivery capacity of Panhandle Eastern and Michigan Transmission Systems to 307,000 M. c. f.; what annual sales are contemplated by this exhibit?

A. In preparing this exhibit, I did not go into annual sales at all. This exhibit is merely to show the investment and the steel required to build the daily delivery capacity of the system to 307,000,000 cubic feet per day.

Q. Now, the 307,000,000 cubic feet represents the de-[fol. 9811] liveries to the customers?

A. Represents the delivery capacity or the ability to make 307,000,000 cubic feet deliveries on peak days on a continuous basis—that is, day after day.

Q. Well, you have labelled on the first page of Exhibit 229, the 307,000 M. c. f. as "Total Sales." I take it that

means that is the quantity of gas which is contemplated to be delivered at the various delivery points on the peak day? A. That is correct.

Q. What pressure base was used?

A. 14.73 pounds per square inch, absolute.

Q. Now, if we were to undertake to determine the annual deliveries on the basis of, let us say, a 70 percent load factor, will you state whether I am correct in saying that we would take 70 percent of your total capacity sales of 307,000 M. c. f., and then multiply the result by 365 days?

A. Yes, you are right.

Q. Likewise, if we were to use 90 percent capacity factor or load factor, as it has been used by Mr. Hinton in several of his exhibits, we would take 90 percent of the 307,000 M. c. f., and multiply the result by 365 days, would we not? A. Yes.

Q. Now, am I correct in understanding that the pressure base reflected in your Exhibits 229, 230, and 231, of 14.73 [fol. 9812] pounds per square inch is the same pressure base which Mr. Morton used in his Exhibit No. 40?

A. Yes.

Q. Is my understanding correct that none of the estimated capital additions set forth in Exhibits 229, 230, and 231, are now under construction? I gather that from your statement on the first page of each of these exhibits, that "All facilities required are in addition to certain projects now under construction."

A. That statement is correct as carried on the first page of each exhibit.

However, there is pending the immediate starting of some of the items shown. That is, some of the work is in phase of being planned at this moment, although construction is not under way.

Q. Have any of the items shown in these three exhibits been approved formally by the Board of Directors of Panhandle Eastern or Michigan Gas?

A. As I understand it—and this is purely hearsay—the Board of Michigan Gas Transmission Corporation approved the purchase of two Worthington 1300 horsepower gas compressor units. These two units, when approved by the management of Michigan Gas Transmission, were to be installed at Montezuma Compressor Station.

Panhandle Eastern has assumed the responsibility of [fol. 9813] placing those units in the system at more desirable points, and at the moment plans are being drawn to install one of these units at Tuscola Compressor Station, and one of them at Centralia Compressor Station.

Q. Now, with that exception, have any of the items set forth in these three exhibits been, as yet, approved by the Board of Directors of the companies?

A. With that exception, none, to my knowledge, has been approved.

Q. Have any of these estimated capital additions set forth in these three exhibits, to-wit, 229, 230 and 231, been submitted to the Board of Directors in a budget or any other form for the Board's consideration?

A. In so far as I know, they have not been submitted to the Board.

Q. What is the present peak day capacity of the system?

A. Approximately 250,000,000 cubic feet sales.

Q. In other words, comparable to the 338,000 M. c. f. and 307,000 M. c. f. figures in your Exhibits 229 to 231, inclusive? A. That is correct.

Q. Referring now to Exhibit No. 229, you do not employ the term "Economic" in connection with this exhibit, [fol. 9814] whereas Mr. Hinton employed the term in connection with the 307,000 M. c. f. sales.

Will you explain why you don't have two exhibits covering the 307,000 M.c.f.?

A. Exhibit 229 might properly be labelled "Less Economic", because if you will note, the gas—or a greater proportion of the gas—must come from the Hugoton field due to the construction of a station at Hugoton, Kansas.

If the Commission would so desire, we can prepare another exhibit supplementing or parallelling Exhibit 229, which would show the investment on an economic basis.

Mr. Culton: Would there be any difference in the main line?

The Witness: There would be no difference in the main line, it would be strictly in the field end of the study.

By Mr. Littman:

Q. Wouldn't your Exhibit 47 already reflect, to a large extent, the so-called economic basis?

A. Except for the fact that there is no study—or, rather, there is no study; that is correct—upon which Exhibit 47 was built, which corresponds to 307,000,000 cubic feet per day capacity.

We would have to develop a study which would reflect the effect of carrying 307,000,000 cubic feet sales back to the field.

[fol. 9815] Q. I see.

I note that Column D of Exhibit 40, a copy of which I hand you, shows, for the year 1942, maximum day total main line sales of 305,200 M.c.f., as submitted by witness Morton.

Would that refresh your recollection any?

A. In that event, no doubt, there is in Mr. Hinton's exhibit, then, sufficient data to permit one to derive the economic expenditures for a sales corresponding to 307,000,000 cubic feet per day.

* * * * * * * * *

Q. Are you referring to his early Exhibit No. 42, rather than his recent Exhibits 223 and 224?

A. I refer to his early exhibit. I don't know the number.

Q. I hand you Exhibit No. 42 to refresh your recollection.

A. No doubt the information is contained in Exhibit 42.

Q. Then, in reality, we have a number of studies with respect to capital additions, to wit—that is, studies that were submitted by you—first, your study submitted originally in Exhibit 47, then the three studies which you [fol. 9816] submitted yesterday, to wit Exhibits Nos. 229, 230, 231.

Now, obviously all of these can't be put into effect, can they?

A. No. These are, as I understand it, alternates. It is proposed that the W. P. B. pass upon which of these construction programs will be undertaken.

Q. What about the study submitted originally by you in Exhibit No. 47?

Is that now out the window, so to speak, or is it still within the realm of real probability?

A. Well, I should say that in as much as we are now in a war, that the status of the early years in 47 is very much changed.

Now, it may be possible that we can swing back on to the proposed investments as reflected in the Exhibit 47 at some later date, but for the moment it seems appropriate that we contribute as much as we can to this war effort, and, in doing so, construction programs as are outlined on these three exhibits, 230, 231, and 229, might receive consideration—favorable consideration—by the W. P. B. to that end.

Q. And they might not?

A. Naturally, they might not.

Q. In other words, at this stage, your company does not know what program of capital additions will even- [fol. 9817] tually be adopted and put into effect; is that right?

A. That would seem correct.

Q. Now, you have from time to time employed in your Exhibits 229, 230, and 231, the terms "economic," and "less economic."

What do you mean by that?

A. I borrowed those terms from Mr. Hinton's exhibits, and, as I understand it, the economic basis of conducting our business would be to derive larger quantities of gas from Texas than are reflected on these studies which I have labelled "less economic."

Q. Have you made any economic studies for the purpose of determining the over-all cost of gas on these various bases?

A. No, I have not, but, as I understand it, Mr. Hinton has done so, as you know.

Q. Are you referring to Mr. Hinton's recent exhibits in which he gave the estimates of operations and maintenance cost?

Is that what you are referring to?

A. I refer to that and also to all of his previous work which he has done to determine which is the more economic method of producing our gas supplies.

Q. I didn't have those studies in mind. I had in mind studies that took into account the total cost of gas delivered to the various customers, taking into account depreciation, [fol. 9818] return, and all expenses applicable to those sales on the various bases here presented.

A. I believe that, if you remember, Mr. Hinton testified yesterday that he has made studies to determine which is the better or cheaper way, therefore, the economic way, of bringing gas supplies into Liberal Station.

Q. But he, as I recall it, stated he did not take into account return on investment, depreciation, fixed overhead costs, and so forth, but merely confined his estimate to operations and maintenance.

Now, I am asking you whether you know of any such studies of the character that I have described that have been made by yourself or any other officer of the company?

A. No. I know of no such studies.

Q. Well, obviously such studies would have to be made to determine, in the first instance, whether the various alternatives here suggested are economic or non-economic; isn't that correct?

A. That is probably true.

Q. What additions to facilities would be necessary to continue to meet the present sales?

A. The present sales?

Q. Yes.

A. I don't know exactly what you mean by the present sales.

[fol. 9819] Q. Well, let us take the sales for the year 1941, the full year 1941. Would you need any additional capital requirements to meet the sales that you did meet in 1941?

A. I think that on a previous occasion before this, in this hearing, Mr. Hinton testified on what would be the capital requirements to continue on the present basis, and I think, if you will refer to his testimony again on that occasion, you will find present basis is set up.

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[fol. 9820] Q. Mr. Burnham, confining ourselves to our studies, namely, the studies of additions to the pipe line east of Liberal, what, if any, additional facilites would be required to meet the sales that were made in the year 1941?

A. In the year 1941, the peak day sales experienced during that calendar year was something like 240,000,000 per day. Now, on that basis, and disregarding the fact that in the winter of '41-'42, we made a delivery of something over 250,000,000, I should say that the main line capacity would not have to be increased in future years to [fol. 9821] care for such peaks as were experienced in 1941.

Mr. Culton: And with the same load factor?

The Witness: And assuming the same load factor.

By Mr. Littman:

Q. And as a matter of fact, you wouldn't have to construct any additional capital facilities beyond those that are now constructed in order to meet the 1941-1942 peak of 250,000,000 cubic feet?

A. But remember that during that peak period of the winter of 1942, we had interrupted something like 30,000,000 cubic feet, some of which was for essential industries.

Q. I am speaking of the actual deliveries, Mr. Burnham, of—what was it—250,000,000 cubic feet—on peak day of the 1941-1942 winter?

A. Well, if you will confine yourself to the 250,000,000 cubic feet, yes, we do have capacity to carry that great a peak day sales.

Mr. Culton: Is that continuous capacity?

The Witness: Yes.

• • • • • • • •

By Mr. Littman:

Q. Am I correct in gathering from your testimony that these additional facilities which are set forth in your various exhibits are, in reality, for the purpose of meeting [fol. 9822] additional demands for additional sales?

A. Yes, you are correct.

Q. Mr. Burnham, is there any duplication of facilities set forth in Exhibits 223 and 224 with those set forth in your three exhibits, 229 to 231, inclusive?

A. Yes, there are.

Q. Will you please name the items that are duplicated?

A. In Exhibit 231 I have duplicated in my study, the following items shown on Exhibit 224; Line 12, item K compressor station near Hugoton.

Q. Are you now referring to Exhibit 224? A. Yes.

* * * * * * * * *

Q. Item K?

A. Item K. Line 13, Item L, Dehydration Plant near Hugoton.

Line 14, Item M, Compressor station near Satanta.

Line 16, Item O, Dehydration Plant near Satanta.

Line 17, Item P, looping existing lines, Hugoton field.

There are two items under P which total approximately $64,000.

Q. Several of those items also appear in Exhibit 223, do they not?

[fol. 9823] A. Yes, sir, and referring to my Exhibit 229, I have duplicated in it the following items which are shown on Exhibit 223.

Line 13, Item K, compressor station near Hugoton, Kansas.

Line 14, Item L, Dehydration Plant near Hugoton, Kansas.

Line 15, Item M, the same loop lines in the Hugoton field I mentioned a moment ago, totalling approximately $64,000.

Q. Those items are duplicated also in certain other of your exhibits, are they not?

You merely stated they duplicated certain items in Exhibit 229.

A. And 231. I mentioned 231.

* * * * * * * *

Q. I am sorry.

Are there any duplications between Exhibits 223 and 224 and your Exhibit 230?

A. No.

* * * * * * * *

By Mr. Littman:

Q. I believe you testified, Mr. Burnham, that the $3,660,923 of field pipe lines and measuring stations appear- [fol. 9824] ing on page 3 of Exhibit 230 were the same as those which appear in Mr. Hinton's Exhibit No. 42 under the anticipated load.

A. They were furnished me by Mr. Hinton, and I assume they were taken from his Exhibit No. 42.

* * * * * * * *

[fol. 9825] By Mr. Lee:

Q. Mr. Witness, perhaps this is a repetition of some questions already asked by Mr. Littman, but over-all, have you made any study or prepared any figures to show what the income of the company would be if you had this additional capacity?

A. No, I have not.

Q. It is all predicated, as I understand it, upon what capacity you may need if and when you sell the additional gas to additional customers. By additional, I mean over and above what you have today?

A. We have to build the capacity before we can sell the gas.

Q. I understand that, but it is all predicated upon not today's business and today's customers, but additional customers and additional business; is that right?

A. Well, today's customers' demands are greater than we have capacity today to serve.

Yesterday's customers, we have capacity for. I mean last year's customers.

Q. You mean to say that at the present time the demands are greater than the facilities? A. Yes, sir.

Q. To what extent?

A. Last winter we would have sold, had we had the [fol. 9826] capacity, something in the order of 300,000,000 cubic feet per day.

Q. Well, is it true that so far as the Detroit Company was concerned, that because of their use of their standby facilities, that you did not sell them what you had anticipated you would?

A. That is right.

Q. And is it true that the excess that you had from that source you disposed of elsewhere?

A. Well, it was all thrown in the pot, you might say, but even at that, we were short some 30,000,000, as I testified a moment ago.

Q. And that shortage wasn't caused by the Detroit contract, at least that is true, isn't it?

A. That is right.

Q. What was the cause of the shortage?

A. Well, we just simply did not possess sufficient capacity to meet the demands of our customers. The shortage was caused by customer requirements.

Q. I understand that, but perhaps I didn't make myself clear. Who were the customers that made demands that resulted in a shortage because of your inability to supply those demands?

A. That would be very difficult for me to say, because all of our customers had grown, you might say, during the [fol. 9827] period of the last year, there had been house-heating customers put on in practically every town and village that we served in Missouri, in Illinois, in Indiana, Ohio, and possibly in Michigan—Monroe, particularly—and so the growth was over the entire system, you might say.

You can't put your finger on any one customer and say that he caused an unusual demand on our system.

Q. Now, if you will just pardon me a minute, I would like to get this clear in my mind.

Is it true that the failure of your company—or not failure, but the fact that your company did not supply the requirements, we will say, in some cities of Michigan, outside of the Detroit area, for househeating, is that true because of the nature of the contract?

A. We served all the househeating requirements during that period.

Q. I thought you said a minute ago that in Monroe, for example—

A. (Interposing) I say that all the towns and cities served directly or indirectly from our system grew during the last year—that is, their demands grew.

Q. What you mean is that you could have sold them more if you had the capacity? A. No.

Q. Then I didn't understand you, if you will pardon me.

[fol. 9828] A. What it really amounts to is this: they all grew. We took care of all their requirements, all the domestic requirements, but in that process we had to interrupt from industrial customers some 30,000,000 cubic feet of gas.

Q. Now, that is what I want to get at.

You did not reject any of the requirements throughout your entire system, of domestic customers?

A. No, sir.

* * * * * * * *

Q. What did happen was that in order to do that was: you said you had to forego industrial sales, interrupt industrial sales? A. Yes, sir.

Q. Now, it is also true, isn't it, that your industrial contracts are interruptible contracts?

A. That is right.

Q. And they are interruptible contracts because you, in making them, take cognizance of the fact that the sales must be made, and the obligations must be met, of the domestic customers; isn't that right?

A. That is correct.

Q. So, in that respect, when you make the broad, general statement that you could have sold and had demands [fol. 9829] for—what was it: 300,000,000?

A. Oh, in that order.

Q. Extra cubic feet. That was for the entire year?

A. Not extra; total.

Q. Total cubic feet, as against what you did supply, the difference being what?

A. Some 30,000,000.

Q. 30,000,000. What you mean is—in the last analysis, now, what you mean is that you just didn't serve the industrials and you were entitled not to serve them because, in making the contract in the beginning, you were taking cognizance of the fact that you may have to shut them off in order to take care of the domestic customers?

A. But it so happened that these industrial customers, to whom we had to curtail the sales of gas, were engaged in war production and that was very embarrassing to have to interrupt and curtail the supply of gas in an essential industry.

Q. That is why I asked you to give me the names of those customers.

I don't dispute your word, but I wanted to see if that was really the situation.

A. It is already in the record, Mr. Lee. I testified to that the last time I was here.

Q. All right.

[fol. 9830] Just one more question. Isn't it the custom in the business that you are engaged in, universal custom, that the industrials are interruptible contracts?

A. Certain types of industrials are interruptible.

Q. Now, what types?

A. Interruptible industrials. We have a firm industrial just now about to go on our line, if you would be interested in knowing the difference between a firm and interruptible.

Q. I know what the difference is, but what I am trying to get at, if you will just bear with me a minute, was: these that you failed to supply were not firm industrial customers, but interruptibles.

A. Yes, that is true.

Q. You did supply all of your firm industrials, if you had any at that time, did you not? A. Yes.

Q. So a condition of your sale of gas to industrials who were interruptible is sort of predicated upon a different basis—if I use the proper term—than your firm [indistrial] customers; isn't it? A. Correct.

What is the difference in that distinction?

A. I don't believe that this company, up to date, is serving any firm industrial customers, but we are about to take on a powder plant which will be, as I understand it, [fol. 9831] a firm industrial customer.

Q. Then you will take care of that contract at the expense of foregoing interruptible industrials, won't you?

A. I assume that we will, yes.

Q. Yes, certainly. A man who gets his gas from you on an interruptible basis knows that he is in a category where he is apt to have it shut off at any time and he takes it upon that condition, doesn't he?

A. He signs that kind of an agreement, but he hopes that we will never shut him off.

* * * * * * * *

Q. Isn't it true that all of the industrial gas that you will sell for defense purposes must be on a firm basis?

A. Well, last winter we interrupted some defense gas or curtailed it, notwithstanding.

Q. Was it on a firm basis under the contract?

A. No, the contract specified interruptible.

Q. That is right, but isn't it true that henceforth any industrial gas for defense purposes will absolutely be on a firm basis?

Mr. Culton: We think that is a matter for the defense industries to determine, Mr. Examiner, what kind of a contract they will require.

[fol. 9832] By Mr. Lee:

Q. Well, isn't it obvious that in order to insure the continuity of supply to an industrial that is engaged in defense purposes, isn't it obvious that there will have to be some guarantee of a continuity of the supply of gas, or that they have standby equipment which will enable them to carry on the continuity of their business?

A. That would be the ideal situation.

Q. Yes. So these customers that you complain you were unable to serve, these customers that you say you could have sold 30 million more cubic feet during the last year than you did: did these customers shut down or go out of business because of your failure?

A. Their operations were curtailed.

Q. Did they have standby service of their own?

A. No.

Q. They did not? A. No.

Q. But it would be good judgment on their part to have some standby facilities that would continue to the interruptible customers?

A. That depends on the customer. He might want to gamble with it.

Q. If he gambles with it, and if he doesn't protect himself with a standby facility—such, for example, as butane [fol. 9833] —to serve as a standby when unable to get the regular supply, then that puts a different face on this whole general allegation that you needed 30 million more cubic feet for customers and that you didn't have the facilities to produce it; isn't that so?

A. Well, butane is hardly a practical substitute.

Q. Well, use some other substitute. They are plenty others, aren't there?

In other words, your general allegation, as you gave it on direct examination, impressed me in the beginning as though you had to forego serving, selling, 30 million cubic feet additional because you lacked the facilities, whereas, when you come to break down that general allegation, we find that that applied only to interruptible industrials, and that you did not fail to supply any of your firm demand customers?

A. Except in the case of City of Detroit, we failed to supply our contract.

Q. That wasn't due to your lack of capacity; that was due to the fact that the distribution company in the City of Detroit utilized its standby facilities and cut down their requirements: isn't that true?

A. It is possibly true.

Q. Well, now, isn't it true?

A. That is my understanding of it.

* * * * * * * * * *

[fol. 9834] Q. Well, that puts a different face upon your general testimony then, what you seemed to imply in your direct testimony.

You don't charge your inability to have adequate facilities to the Detroit Company in any way when you know, as a matter of fact, that what the Detroit Company did was to resort to its standby to cut down—we might say "shave" —the peak loads, cut down requirement, but you had that gas to sell elsewhere, didn't you?

A. It went into the general pot, as I said a while ago.

Q. That is right. So when we get right down to the final breakdown of this statement of yours, isn't it true that it comes to this situation: that what you are complaining of—or what you are alleging—I don't say "complaining—what you are alleging is that you could have sold 30 million more cubic feet of gas than you did last year, but you took care of all your domestic customers, you took care of all your industrial firm customers, if you had any, and the failure to produce the 30 million extra had all been taken cognizance of by both you and the customer when the contract was made: isn't that true?

[fol. 9835] A. That seems to be a fair statement.

Q. You made a statement a minute ago that a standby facility for an industrial, such as butane, was not very desirable: is that right?

A. I am referring particularly to some of the industrials that we curtail—a brick plant, for instance. I think it would be almost prohibitive for a brick plant to put in butane standby.

* * * * * * * * * * *

Mr. Culton: Mr. Lee, it has been commented that it would be rather difficult, under the present setup, to obtain permits for butane standby equipment.

Mr. Wheat: Those are covered, as you probably know, under Order M 68 of O. P. C., of the Office of Petroleum Coordinator, and are strictly prohibited, except on special permission, which I understand is exceedingly difficult to obtain at this moment.

[fol. 9836] I thought you might like to know that situation on butane.

Mr. Lee: I have heard that.

By Mr. Lee:

Q. But that is why your future contracts for industrials engaged in defense purposes are going to be firm guarantee contracts, aren't they?

A. I don't know.

Q. Well, it is a good reason why, isn't it? Isn't that true?

A. I would say that a defense industry would be able to probably get standby equipment, but the instance that I cited a moment ago, natural gas is essential to that operation, and no other fuel or product will take its place. Therefore, that is a firm contract.

Q. But you can't give me the name of any brick company that you had to deny gas to?

A. Oh, yes, I can. I did name those plants in my testimony.

Q. Weren't they generally brick and tile and ceramic and glass? A. Yes.

By Mr. Littman:

Q. Mr. Burnham, when the W. P. B. orders you to sell gas to an industry closely affiliated or connected with the [fol. 9837] war effort in such manner as to not interrupt the flow of gas to that industry, then, to all intents and purposes, notwithstanding any contract, the industrial firm becomes a user of firm gas, does it not?

A. Yes, if the order has the authority to make it stick.

Q. And that is true notwithstanding the fact that that industry may have a contract with your company providing for interruption?

A. That is true.

* * * * * * * * * * *

[fol. 9838] Leith V. Watkins, a witness previously called and duly sworn, resumed the stand and was examined and testified further as follows:

Mr. Culton: Mr. Examiner, during the intermission we passed around to various counsel numerous documents which we would now like to have marked with exhibit numbers for identification, and I shall list them all at this time.

First, we ask that the document entitled "Prospectus—Panhandle Eastern Pipe Line Company" to which there is a rider relating to the price and dated April 2, 1942, be marked Exhibit No. 233 for identification. There is also another rider in the body of the document.

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(The Document referred To Was Marked Exhibit No. 233 For Identification.)

Mr. Culton: We next ask that a document entitled "Summary of Construction and Retirement Budget and Work Order Procedure" be marked Exhibit No. 234.

Trial Examiner: It will be so identified.

[fol. 9839] (The Document Referred To Was Marked Exhibit No. 234 For Identification.)

Mr. Culton: We next ask that a statement entitled "Statement Showing the Computation of Depreciation for Federal Income Tax Purposes for the Year 1939 as Claimed in Federal Income Tax Returns" be marked Exhibit No. 235.

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(The Document Referred To Was Marked Exhibit No. 235 For Identification.)

Mr. Culton: We next ask that a document entitled "Statement Showing the Computation of Depreciation for Federal Income Tax Purposes for the Year 1939 on the Basis as Settled with the Bureau of Internal Revenue" be marked Exhibit No. 236.

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(The Document Referred To Was Marked Exhibit No. 236 For Identification.)

Mr. Culton: We next ask that document entitled "Statement Showing the Computation of Depreciation for Federal Income Tax Purposes for the Year 1940 as Claimed in Federal Income Tax Return" be marked Exhibit No. 237.

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(The Document Referred To Was Marked Exhibit No. 237 For Identification.)

Mr. Culton: I next ask that the document entitled "Statement Showing the Computation of Depreciation for [fol. 9840] Federal Income Tax Purposes for the Year 1940 on the Basis as Settled with the Bureau of Internal Revenue" be marked Exhibit No. 238.

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(The Document Referred To Was Marked Exhibit No. 238 For Identification.)

Mr. Culton: We next ask that a document entitled "Analysis of Account 795, Special Services—Years 1940 and 1941—Panhandle Eastern Pipe Line Company and Subsidiary Companies" be marked Exhibit No. 239.

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(The Document Referred To Was Marked Exhibit No. 239 For Identification.)

Mr. Culton: We ask that a document entitled "Analysis of Account 795, Special Services—Year 1941—Panhandle Eastern Pipe Line Company and Subsidiary Companies (including Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation)" be marked Exhibit No. 240.

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(The Document Referred To Was Marked Exhibit No. 240 For Identification.)

Mr. Culton: We ask that a document entitled "Analysis of Account 796, Special Legal Services—Years 1940 and 1941—Panhandle Eastern Pipe Line Company and Subsidiary Companies" be marked Exhibit No. 241.

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[fol. 9841] (The Document Referred To Was Marked Exhibit No. 241 for Identification.)

Mr. Culton: We next ask that a document entitled "Analysis of Account 796, Special Legal Services—Year 1941—Panhandle Eastern Pipe Line Company and Sub-

sidiary Companies (including Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation)" be marked Exhibit No. 242.

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(The Document Referred To Was Marked Exhibit No. 242 For Identification.)

Mr. Culton: We ask that the document containing several pages, entitled "Statement of Estimated Federal Income and Excess-Profit Taxes for the 12 Months Ended February 28, 1942 (based on Revenue Act of 1941)," so far as page 1 is concerned and based on rates proposed in recommendation by Secretary of the Treasury Morgenthou as shown on page 2 with an explanatory statement on page 3, be marked Exhibit No. 243.

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(The Document Referred To Was Marked Exhibit No. 243 For Identification.)

Mr. Culton: We ask that a document entitled "Statement of Budget Items Included in Exhibit No. 205—Projects Approved in Year 1941 Which Were Unfinished at the Date Shown" be marked Exhibit No. 244, that document being a two-page document.

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[9842] (The Document Referred To Was Marked Exhibit No. 244 For Identification.)

Mr. Culton: We next ask that printed document entitled "Agreement Between Columbia Gas & Electric Corporation and Panhandle Eastern Pipe Line Company dated February 5, 1942," be marked Exhibit No. 245.

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(The Document Referred To Was Marked Exhibit No. 245 For Identification.)

Mr. Culton: We ask that a document showing, "Preliminary Determination of the Second Installment of Purchase Price to Be Paid to Columbia Gas & Electric Corporation," be marked Exhibit No. 246.

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(The Document Referred To Was Marked Exhibit No. 246 For Identification.)

Mr. Culton: We ask that the document entitled "Certain Increased Costs Not Fully Present in Income Account" be marked Exhibit No. 247.

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(The Document Referred To Was Marked Exhibit No. 247 For Identification.)

Mr. Culton: We ask that a document entitled "Pro Forma Consolidated Income Account for the Year Ending [fol. 9843] December 31, 1941," be marked Exhibit No. 248.

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(The Document Referred To Was Marked Exhibit No. 248 For Identification.)

Mr. Culton: We ask that a document entitled "Pro Forma Consolidated Income Account for the Year Ending December 31, 1941, Adjusted to Give Effect to Income and Excess Profits Tax Rates Proposed by Secretary Morgenthau" be marked Exhibit No. 249.

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(The Document Referred To Was Marked Exhibit No. 249 For Identification.)

Mr. Culton: We ask that a document showing "Statement of Rate Case Expenses in connection with G-200 and G-207, Including Actual Cost, to February 28, 1942, and Estimated Cost to Complete," be marked Exhibit No. 250.

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(The Document Referred To Was Marked Exhibit No. 250 For Identification.)

Mr. Culton: We ask that a document consisting of several pages and captioned on the first page, "Pro Forma Consolidated Net Operating Revenue as Adjusted for a Full Year's Costs (Note A) as Allocated Between Regulated and Non-Regulated Sales for the Year Ended December 31, 1941," be marked Exhibit No. 251.

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(The Document Referred To Was Marked Exhibit No. [fol. 9844] 251 For Identification.)

Redirect Examination.

By Mr. Culton:

Q. Mr. Watkins, will you please briefly explain Exhibit 232?

A. Exhibit No. 232—I do not believe this witness is involved—

Q. (Interposing) Exhibit No. 233, I beg your pardon, sir. I had the wrong figure there. Will you please explain Exhibit No. 233 which is the prospectus of Panhandle Eastern Pipe Line Company?

A. There has heretofore been introduced in these proceedings as Exhibit No. 146 the prospectus of Panhandle Eastern Pipe Line Company with respect to $10,000,000 first mortgage and first lien 3 percent bonds, Series C, due January 1, 1962, and 150,000 shares "blank" percent cumulative preferred estock (par value $100 per share). On April 2, 1942, in compliance with the regulations of the Securities and Exchange Commission, it became necessary to attach to the prospectuses to be delivered subsequent to that date, a rider with respect to the change in offering price of the 150,000 shares of the 5.60 percent cumulative preferred stock.

The rider simply states that certain of the purchasers named in the prospectus are making available for sale to approved dealers certain shares of the stock at an offering [fol. 9845] price less a concession of $1.50 per share.

There is also a rider attached to page 53 which became necessary as a result of an order issued by the Securities and Exchange Commission on March 31, 1942, under the Public Utility Holding Company Act of 1935, covered by Holding Company Act Release 3415, which the witness believes is self-explanatory.

Q. You mentioned a portion of the provisions on the first rider. What change was made in the first rider as to the purchase price to the public, the offer price?

A. The price was changed to $100 per share flat.

Q. From what?

A. From the previous price of $104 plus accrued dividends.

Q. Will you now explain Exhibit No. 234 and state the reason for the preparation of that exhibit?

A. Exhibit No. 234 is a condensed summary of the construction and retirement budget and work order procedure used by Panhandle Eastern Pipe Line Company and its subsidiary companies. Its preparation came about in response to a request made by the counsel for the Commission to Witness Hinton in a previous session in this matter.

Q. Does this Exhibit No. 234 show in detail the policy of the company with respect to such budgets and work orders and reflects the ordinary course that such matters take?

A. Not so much the policy, sir, but it does reflect the [fol. 9846] ordinary course and gives, in a condensed form, the routine through which their preparation proceeds.

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Q. Now, will you explain together Exhibits Nos. 235, 236, 237, and 238? I think you can probably discuss those four at one time.

A. Exhibits Nos. 235, 236, 237, and 238 were prepared in response to a request made by Mr. Goodman at page 8941 of the transcript of the proceedings in this matter for the session of March 30, 1942.

The first of these exhibits shows computation of depreciation for Federal income tax purposes for the year 1939 as claimed in the Federal income tax returns and is, the witness believes, in sufficient detail for its complete understanding.

Q. But it shows what total?

A. A total of $2,381,293.48 in Column H opposite lines 31 and 32.

Exhibit No. 236 comprises a statement giving the computation of depreciation for Federal income tax purposes for the same year, 1939, on the basis of the company's settlement with the Bureau of Internal Revenue and provides a total of $2,186,243.66 in Column F opposite lines 23 and 24, which amount is comparable to the figure of $2,381,293.48 heretofore identified by this witness as ap-[fol. 9847] pearing on Exhibit No. 235.

Exhibit No. 237 for identification consists of a statement showing the computation of depreciation for Federal income tax purposes for the year 1940 as claimed in the income tax return for Panhandle Eastern Pipe Line Company and subsidiary companies. The total of such claim was $2,640,225.34 as shown in Column H opposite lines 33 and 34. The basis of the settlement for the year 1940 is shown on Exhibit No. 238 in Column H opposite lines 21 and 22. Here it should be stated that the amount there shown, $2,301,752.34, is not the actual basis of settlement for the reason that the return for the year 1940 has not been completely examined.

The matter presented in this exhibit has been computed, as nearly as it has been possible for the company to do, on the basis of the anticipated settlement with the Revenue Department and conforms to the settlement basis for the year 1939 as shown by Exhibit No. 236.

Q. I think you might now explain Exhibits Nos. 239 and 240 together and you might state the reason for the preparation of those exhibits also.

A. Exhibits Nos. 239 and 240 for identification were prepared in response to a request made by counsel for the Commission at pages 8981 and 8991 as shown by the transcript of the testimony in this matter for the session of March 30, 1942.

[fol. 9848] The first of the two exhibits, namely No. 239, consists of an analysis of Account 795, the title of which is "Special Services." This analysis covers the years 1940 and 1941 and is for Panhandle Eastern Pipe Line Company and subsidiary companies, excluding Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation, which did not become subsidiary companies of Panhandle Eastern Pipe Line Company until February 6, 1942.

This exhibit presents, in the order named, the name of the person performing the special service, the type of service, the amount of fees, expenses, and the total of such costs for both years 1940 and 1941, the latter information appearing in Columns (C), (D), (E), (F), (G), and (H).

Exhibit No. 240 for identification is a compilation of the analysis of this account, No. 795, Special Services for the

Year 1941, which includes, in addition to the costs of this nature experienced by Panhandle Eastern Pipe Line Company and Illinois Natural Gas Company, similar costs experienced by Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation, and is a presentation for the year 1941 as though the latter of these companies were actually subsidiaries of Panhandle Eastern Pipe Line Company during that year.

Q. Now, will you explain Exhibits Nos. 241 and 242?

Mr. Littman: Just a minute, Mr. Culton. I would like [fol. 9849] to inquire whether Panhandle Eastern proposes to retain the services of Columbia Engineering Corporation in future years, including 1942.

The Witness: The contracts with Columbia Engineering by Michigan Gas Transmission and Indiana Gas Distribution Corporation were canceled on February 6, 1942.

Mr. Littman: I note from Exhibit No. 240, line 11, that Columbia Engineering Corporation received the sum of $23,731 for "Services and Expenses under Engineering Contract" for the year 1941. Is that correct?

The Witness: That is a correct statement of what appears on the exhibit, yes, sir.

Mr. Littman: That, I take it, was paid by Michigan Gas Transmission Corporation, was it not?

The Witness: And Indiana Gas Distribution Corporation.

Mr. Littman: You do not expect to have that item of expense in 1942, do you?

The Witness: Not in its precise nature, no, sir, and there is no expectation, as far as this witness knows, that there will be any such expense arising from any services performed by Columbia Engineering and Management Corporation.

I am not able to say there will not be similar expenses of some nature incurred in some other direction within the organization; my statement meaning simply that because of the elimination of the engineering contract, it would not [fol. 9850] necessarily follow that expenses aggregating

this approximate $24,000 might not be present in the operation for such years.

Is that sufficient, sir?

Mr. Littman: For the present, yes. That is all.

By Mr. Culton:

Q. Will you explain Exhibits Nos. 241 and 242?

A. Exhibits No. 241 and No. 242 for identification have been prepared in the same manner and for the same purpose as were Exhibits Nos. 239 and 240 for identification. The information contained in the two exhibits being so similar to the previous ones, might we pass them without further explanation?

Q. I believe you were heretofore requested to make some kind of a report or investigation with respect to Exhibit No. 192?

A. Yes, sir. At page No. 8998 of the transcript of the proceedings in this matter for the session of March 31, such a request was made, and it is explained that the difference between the amount of $153,000—

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Exhibits Nos. 191 and 192—I believe they have been [fol. 9851] received, have they?

Q. They have been identified, I know, and I think they have been received.

A. Exhibits Nos. 191 and 192 were reconcilements of the net income, per books, with the net income per Federal income tax returns for the years 1939 and 1940, and, in the session of March 31, 1942, in this proceeding, a question arose as to two amounts, these amounts appearing opposite lines 27 and 28 of Exhibit No. 191, and opposite lines 22 and 23 of Exhibit No. 192, being $153,053.56 and $715,162.16, respectively. The difference between the two amounts is the result of the fact that Exhibit No. 191 was prepared to give a reconcilement of net income, per books, with the taxable net income on the basis of the settlement with the Bureau of Internal Revenue for the year 1939, while the data shown on Exhibit No. 192 was predicated on a reconcilement of a return as filed, per the books, without giving effect to the expected settlement basis. However, had a settlement for the year 1940 been made

precisely in the same manner as for the year 1939, the comparison would have been as between $153,053.56 and $256,769.05.

The difference of $458,393.11 between the latter figure and $715,162.16 is explained as follows: In the year 1940, the depreciation claimed was on a wasting asset basis and amounted to $2,706,029.59. The Bureau's settlement basis [fol. 9852] of this same amount, as nearly as the Company can anticipate it, if such settlement conforms to the treatment in the prior year, 1939, would have been $2,247,636.48, and the difference between these two amounts is $458,393.11.

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[fol. 9853] Mr. Littman: Have you given any explanation anywhere in the record, Mr. Watkins, as to the method and manner by which you arrive at this $7,350,000 of estimated excess profits net income for the year 1941, which figure is shown in the middle of page 3 of Exhibit No. 243?

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The Witness: I doubt if such explanation has been given. I do not find it from a hasty perusal of the transcript of the proceedings for the session of April 1.

Mr. Littman: Can you tell us how you arrived at that figure of $7,350,000?

The Witness: Mr. Littman, of course, in making our tentative income tax return for the year 1941, we must have some idea of approximately what our tax may be and, as you know, the Internal Revenue requirements are such that we must estimate our net income and our tax as well and make a token payment provided we do not file a complete return.

We did not file a complete return. We had an extension of time in which to file our return, and the $7,350,000 was [fol. 9854] determined through our customary procedure of what our tax liability may be at the end of the year at the time our books were closed as well as our estimate used in connection with the filing of the return itself, that is, a preliminary return.

Mr. Littman: Can you enlighten us as to how this figure of $7,350,000 was determined? I have no desire to impede the progress of your presentation of your exhibits, Mr. Watkins. If you would prefer to give us the data later, very well, unless you feel you can give it now.

The Witness: I can answer your question right now. If you will refer to Exhibits 191 and 192 which are a reconcilement of net income, per books, with net income tax returns for the years 1939 and 1940, the determination for the year 1941 was made in exactly the same manner as shown here. I do not have it with me, however. Corporations make accrual for this purpose monthly, and as its accounting periods progress during the year's work, you must make some sort of an estimate as you go along.

Mr. Culton: That was the reason for the estimate of $7,350,000?

The Witness: That is correct, sir, and the witness does not know anything at this particular time that will change that figure greatly.

Mr. Littman: Mr. Watkins, I believe that we ought to [fol. 9855] have in this record a reconciliation between the $7,350,000 of estimated excess profits net income for the year 1941 and the net income, per books, for the year 1941. I wonder whether you could supply that for us.

The Witness: You are the doctor, sir.

Mr. Littman: I would greatly appreciate it, for I think it would greatly assist our staff and the Commission.

The Witness: You understand, of course, the filing is tentative.

Mr. Littman: Yes, I understand.

The Witness: In the event we have completed our actual return for the year 1941, would you prefer the reconciliation between the net taxable income as shown by the return and the books rather than this estimated amount which we find in Exhibit No. 243?

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Mr. Littman: We would prefer the actual if it is available when you submit it.

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[fol. 9856] Mr. Littman: I would like to have all companies, as your Exhibit No. 243 shows all companies.

The Witness: You want the information for all companies rather than a reconcilement of Panhandle Eastern alone?

Mr. Littman: Individually and collectively. In other words, I would like it in the same manner as Exhibit No. 243 presents the data.

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The Witness: We will get it.

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Mr. Littman: I would like to refer to Exhibit No. 241. I note a rather large item on Exhibit No. 241, line 5, giving payment to Edward N. Goodwin, general counsel, in the amount of $50,366.81 in 1940, and $44,824.97 in the year 1941, for fees and expenses.

Can you enlighten us with respect to the nature of the services rendered by Mr. Goodwin, in connection with what particular transactions or litigation or what not were his [fol. 9857] services rendered?

The Witness: Mr. Littman, I could not profess to have at instant call all of the wide variety of matters that the general counsel for the company had his fingers in in the years 1940 and 1941.

I believe your knowledge of legal lore and so forth, if you were to refer to the company's filings with the Securities and Exchange Commission and the matters that you have personal kowledge of that have been before the Securities and Exchange Commission would cause you very soon to reach the conclusion that Mr. Goodwin and his staff had no doubt been quite busy. I do not have information with me that would be sufficient to give you a categorical answer to your question and if a request

were made for such information, it would involve the analysis of all of the statements rendered by Mr. Goodwin which detailed the services which he had performed and those statements are usually two or three pages long of closely typed matter each month. He has been a very busy gentleman and his staff has been very busy.

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Mr. Culton: His services are not confined to work in the office of the company but he is engaged in the outside prac- [fol. 9858] tice of law, is he not?

The Witness: That is correct.

Mr. Culton: And he is not merely counsel for the company?

The Witness: No.

Mr. Littman: Mr. Clark is general counsel for the company, is he?

The Witness: Not general counsel. Mr. Goodwin is general counsel. Mr. Clark is company counsel. We distinguish between the services of the two in this fashion: Mr. Clark, in the offices of the company at Kansas City, is cognizant, of course, with all the legal matters with which the company is confronted. Their duties have to do with the every-day affairs concerned with corporate procedure or with respect to special work for various governmental commissions and what not.

Mr. Littman: I take it that Mr. Goodwin's services have been rendered chiefly in connection with proceedings before the S. E. C.?

The Witness: And in an advisory manner with respect to general corporate affairs, annual meetings of stockholder, directors' meetings, any general contracts, and any question we wish to ask him, whatever the nature may be.

Mr. Littman: Are these fees paid on a retainer basis or are they billed as the services are rendered?

The Witness: We pay Mr. Goodwin no retainer.

Mr. Culton: Did you have any public financing in either [fol. 9859] of those two years?

The Witness: Yes, we did.

Mr. Culton: And Mr. Goodwin represented the company in connection with that refinancing operation?

The Witness: He did, and not only that but all of the matters precedent to that financing and the clean-up work after the development of stock certificates, bonds, indentures, and the very wide variety of attendant matters that go along with substantial financing transactions.

Mr. Littman: In other words, a large part of Mr. Goodwin's services were rendered in connection with refinancing and the issuance of securities by Panhandle Eastern during the past year?

The Witness: During the past two years, I think that would probably be a fair statement, Mr. Littman, but I do not wish to be tied down to try to give you specifically what proportion of Mr. Goodwin's services were performed for anything because, frankly, I do not know.

Mr. Littman: Did he assist in the preparation of the indentures and prospectuses that were issued?

The Witness: I should say he did.

Mr. Littman: Were any part of his fees charged to that discount and expense?

The Witness: They may have been.

Mr. Littman: That is, you mean parts of these amounts [fol. 9860] that appear in line 5 of Exhibit 243 may have been?

The Witness: No, these amounts are for special services as defined in Account No. 796. Now, there may have been other charges for Mr. Goodwin that were charged to work orders in which the company accumulated the costs of some of its financing.

Mr. Littman: Do you expect to have any such expense as $44,000-odd for the year 1942—

The Witness: (Interposing) It would not astonish me if it were not that much or even more.

Mr. Littman: At least that much?

The Witness: Of course, I have no way of knowing and I am not a crystal gazer, but, as I say, I would not be astonished, from my knowledge of the company over the years and the ability of certain ones to cause it to undergo costs of this nature, for that cost to be exceeded without too much trouble.

Mr. Littman: It might be considerably lower too, might it not?

The Witness: That could be, too, yes, but I doubt it.

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[fol. 9861] By Mr. Culton:

Q. Will you explain Exhibit No. 243, Mr. Watkins, and explain it in comparison with Exhibit No. 202 or its lack of similarity?

A. Exhibit No. 243 is referable to Exhibit No. 198. Subsequent to the last presence of this witness in this matter, we found that there had not been supplied a statement showing the estimated Federal income and excess profits tax for the 12 months ended February 28 as shown by Exhibit No. 198, as had been the case with regard to certain other exhibits.

Now, Exhibit No. 198 was introduced at page 9166 of the transcript of testimony at a previous session and it consists of a portrayal of the method the companies—and here we have Panhandle Eastern, Illinois Natural, Michigan Gas Transmission Corporation, and Indiana Gas Distribution—used in estimating the excess profits and net income and surtax taxes for the 12 months ended February, 1942. Page 1 gives this information based on the Revenue Act of 1941 and shows a total estimated tax for this purpose. It shows a total tax for all of the companies for that 12 months period of $4,362,229 in column N opposite line No. 43.

Page 2 furnishes similar information for all of the companies but is based on rates proposed in the recommendation made by Secretary of the Treasury Morgenthau on [fol. 9862] March 3, 1942, and develops a total of $6,199,475 in column N, as shown on line 43, as contrasted with $4,362,229 based on the Act of 1941.

Page 3 of this exhibit explains certain adjustments used in the development of the data in the two preceding pages.

Q. I believe you were heretofore requested to give some information about the routine budget on page 9185 of the record?

A. Yes, sir. At that point of the record, Exhibit No. 204 was offered and I believe later accepted. This exhibit consisted of several pages comprising the 1942 routine construction and retirement budgets of Panhandle Eastern Pipe Line Company and subsidiary companies as they then existed, which included Illinois Natural alone. At the time the exhibit was introduced, there were not sufficient copies to distribute one to everyone represented in the matter and arrangements were made and additional copies sent to those who were short-changed. I believe they were mailed on April 1.

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Q. Now, will you explain Exhibit No. 244?

[fol. 9863] A. Exhibit No. 244 for identification is an itemized statement of budget items included in Exhibit No. 205. These show projects approved in the year 1941 which were unfinished on the dates of December 31, 1941, and February 28, 1942.

Exhibit No. 205 gave these totals of unfinished work at December 31, 1941, and February 28, 1942, of $7,433,000 and $5,396,000, respectively. The information in that instance, however, was simply totals, by company.

Exhibit No. 244 for identification identifies the specific budget items that made up the totals.

Q. Do you have available the amount of expenditures to date on Items 552R and 553R as shown on Exhibit No. 244?

A. Yes, I have.

Q. What is the amount of them?

A. The amounts of expenditures to February 28, 1942, on Budget Items Nos. 552R and 553R, being the Michigan-North Line and Michigan-West Line, respectively, were $1,605,000 for Budget Item No. 552 and $180,000 for Budget Item No. 553, a total of $1,785,000 against an original authorization or rather revised authorization of $5,145,000, and work is progressing constantly since that date.

Q. Mr. Burnham this morning testified with respect to certain items for which arrangements have recently been made. Do you have budget items on those?

A. That is, the proposed additions at Centralia and [fol. 9864] Tuscola stations?

Q. That is right.

A. Yes, there have been forwarded to the Secretary budget items Nos. 587 and 589, which were approved by all the operating officials on April 3, 1942, and they call for the construction of certain additions at the Centralia station and Tuscola station and are in the amounts of $166,400 and $164,600, respectively.

Q. That item has not yet been presented to the board?

A. It has not, but the witness' observation of the method in which the board has heretofore acted with respect to such items would not indicate to him anything but its approval.

Mr. Littman: Just a minute. I would like to ask that the latter part of that answer go out. It is just purely a hazard, a guess.

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Trial Examiner: That portion of the answer following the statement, "It has not," may be stricken.

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[fol. 9865] Mr. Littman: Mr. Watkins, referring to Exhibit No. 244, what do you mean by the term "Regular" and the term "Expansion" as used here on the first page of that exhibit?

The Witness: I believe we went through that before, didn't we, Mr. Littman?

Mr. Littman: Those terms are not used on your Exhibit No. 205 to which it refers.

The Witness: No, but we did cover routine construction and retirement budgets and expansion budgets.

Exhibit No. 205 to which it refers was a statement showing certain estimated construction expenditures for the year 1942 and did not purport to segregate such amounts as between regular and expansion programs. If, however,

counsel for the Commission were to refer to the last page of Exhibit No. 204, he would find there that such a segregation has been made.

Mr. Littman: By "Expansion" do you mean that these projects are for the purpose of enabling Panhandle Eastern to serve new markets?

The Witness: The witness has a rememberance that a question similar to that was put to him at the time Exhibits Nos. 204 and 205 were introduced, and his reply went to the general order that, so far as the actual production of new business for any of the total of $8,080,400, as shown by Exhibit No. 204, or either the $7,433,000 or $5,396,000, as [fol. 9866] shown by Exhibit No. 205, was concerned, that such a question would have to be directed to someone else.

Mr. Littman: I see. I believe Mr. Burnham probably covered that this morning.

Is my understanding correct that all of the expenditures shown in Exhibit No. 244 have been approved by the Board of Directors of Panhandle Eastern and Illinois Natural Gas Company and Michigan Gas Transmission Corporation?

The Witness: Michigan Gas Transmission Corporation, sir; I would hesitate to state too specifically about that. But my knowledge, however, of their budgetary procedure is such that I think it could be very safely assumed that such approval has been had. As to Panhandle Eastern and Illinois Natural, there is no doubt about that fact.

Mr. Littman: Now, do you know whether construction is actually in progress on all of these projects shown in Exhibit No. 244?

The Witness: If you will bear with me a moment—yes, the information I have with me seems to indicate that work is actually under way on all of them.

Mr. Littman: Have you received the pipe for all of these?

The Witness: I could not answer that question, sir.

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[fol. 9867] By Mr. Culton:

Q. Mr. Watkins, I believe Exhibit No. 245 is the next exhibit. Will you please explain that?

A. Exhibit No. 245 for identification is an agreement between Columbia Gas & Electric Corporation and Panhandle Eastern Pipe Line Company dated February 25, 1942, and is presented as an exhibit in this proceeding because of the fact that the purchase price to be paid to Columbia Gas & Electric Corporation for the stock and debt of Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation is subject to further determination.

Paragraph (e) of the agreement provides that a second installment be paid upon the purchase price, and then there is also a provision in the contract with respect to the treatment of the matters pertaining to income taxes for prior years.

The following exhibit, No. 246, if I may proceed with that, sir?

[fol. 9868] Q. If you will, please.

A. Exhibit No. 246 gives a preliminary determination of the second installment of the purchase price and, signified, consists of the net income of Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation for the month of January and 5/28 of the net income of the two companies for the month of February, the total, subject to further determination, being $77,462.02. Final determination of this installment cannot be made until the enactment of the Revenue Act applicable to the year 1942, if there be such an act, and I do not believe there is any question about the fact there will be one and it won't be be "hay".

Q. In other words, this shows the additional purchase price that will have to be paid over and above that which was paid at the time the stock and bonds were delivered?

A. Part of the original purchase price, sir, and as yet undetermined. Just what will happen to the tax side of that determination is something that no one can foretell at this moment.

Trial Examiner: Was this further settlement in contemplation when the Securities and Exchange Commission gave its approval?

* * * * * * * *

The Witness: I think it was. At least, the contract [fol. 9869] which we are now submitting as Exhibit No. 245, I am quite positive, has the "blessing", perhaps, of the Securities and Exchange Commission.

By Mr. Culton:

Q. Now, will you explain Exhibit No. 247?

A. Exhibit No. 247 consists of a presentation of certain increased costs already authorized but not fully included in the company's expenses for the year 1941. Any explanation of this exhibit should be preceded by a statement that it is not here intended to portray, by any means whatever, all of the increased costs that were suffered by Panhandle Eastern Pipe Line Company and subsidiary companies for the year 1941.

This simply selects some of those increased costs which are not fully present in the operations for that year and shows the amount included in the operations for 1941 together with the remaining portion of the annual authorization which would have been present had such authorizations been made, shall we say, as of January 1, 1941.

Q. Will you please take those items up separately and explain them, please?

A. On May 1 and July 1, 1941, the field employees of Panhandle Eastern Pipe Line Company and Illinois Natural Gas Company were granted pay-roll increases having an annual amount of $22,800 as shown by Column (B), line 4, of Exhibit for identification No. 247. The amount of that [fol. 9870] authorization included in expenses for the year 1941 is shown in Column (C) to (L), inclusive, the remaining portions shown in Columns (M) and (N) opposite lines Nos. 3, 4, and 5, being $4,000, to be charged to Account No. 759-111, and $4,200 to be charged to Account No. 759-21, both accounts being those prescribed by the Commission in its Classification of Accounts.

Q. In other words, had the same scale which was effective at the end of the year been effective from the beginning

of the year, the additional amount which would have been included in the expense account for 1941 would have been $8,200 as to the first item?

A. That is correct, sir.

Q. Now, will you explain what the second item of $22,800 represents?

A. That item represents a change in pay-roll base granted to the employees of Michigan Gas Transmission corporation on July 1, 1941, and likewise amounted to $22,800 as shown by Column (B) on line 7, the amount of such authorization not fully included in expense for the year 1941 being $11,400.

Q. Which would be from January to June, inclusive, is that correct?

A. That is correct, yes, sir, and would have been charged to the accounts shown in Columns (M) and (N) in the amount shown in Column (N) of this exhibit.

[fol. 9871] There is no similarity between the two amounts of $22,800 shown in Column (B). It is just a mere coincidence.

Q. Now, will you explain the third item?

A. As a result of the change of hours in the work week of the field employees of Panhandle Eastern Pipe Line Company and Illinois Natural Gas Company made about the 1st of August, 1941, the company obligated itself to an annual increase of $92,400, as shown in Column (B) opposite line No. 13. Of this amount, $53,900 had not made its appearance in the expense accounts of the company for the year 1941. Charges for these amounts are being currently made to Accounts Nos. 759-111 and 759-21 of the Classification of Accounts prescribed by this Commission.

Q. Will you next explain the fourth item?

A. There has been considerable discussion, I believe, in the record about the necessity for and advisability of emergency protection of the facilities of not only Panhandle Eastern Pipe Line Company and Illinois Natural Gas Company, but Michigan Gas Transmission Corporation as well. We all know and regret exceedingly the occurrence that took place early in December, 1941, that gave rise to this necessity.

Q. It is protection against action by fifth or sixth columnists, or anybody else who is acting against the governmental interests at this time, is that it?

A. Not only that, but to insure continuity of service [fol. 9872] and it is just general, all-round, good business to have protection against the causes you mentioned.

Q. That includes the hiring of a considerable number of guards, does it?

A. It does, sir, and it seems to me it is something on the order of 120. I am not sure of that amount. I know Panhandle Eastern has in the neighborhood of 85 or maybe 90, the remainder being on the property of Michigan Gas Transmission Corporation.

That information is already in the record.

Of the total amount authorized in Column (B) opposite lines 18 and 19, there was $149,500 and $72,000 not present in the accounts at December 31, 1941. These amounts are being currently incurred and will be present in the expense accounts hereafter.

Q. Will you explain the next item, that of "Rate Case Expense"?

A. The combined annual amortization of Panhandle Eastern Pipe Line Company and Michigan Gas Transmission Corporation for costs actually incurred and those estimated to complete this proceeding is anticipated to be amortized on the basis of $70,000 per year. Whether or not the $350,000 shown opposite line 25 in Column A of Exhibit No. 247 for identification is actually incurred, it is the company's present intention to amortize the costs on a basis of $70,000.

[fol. 9873] Michigan Gas Transmission Corporation began its amortization in July, and, in the year 1941, charged to expense $6,000. Panhandle Eastern did not begin its amortization until January 1, 1942, and, beginning with the month of March, the amortization of those two companies, the monthly amortization, will be synchronized with an annual amount of $70,000.

Q. How was Panhandle Eastern's expense carried prior to the 1st of January, 1942?

A. It was carried in a deferred account pending determination as to the proper procedure with respect to its amortization.

Q. You have a subsequent exhibit showing how you arrived at the $350,000, do you? A. That is correct.

Q. Now, will you explain the last item in Exhibit No. 247?

A. If Michigan Gas Transmission Corporation had been a subsidiary of Panhandle Eastern Pipe Line Company at the time Panhandle Eastern adopted its pension plan, Michigan Gas would likewise have participated.

We are engaged at this very moment in working out a plan for the inclusion of Michigan Gas Transmission's employees under Panhandle Eastern's group annuity contract. The cost of the inclusion of the eligible employees of Michigan Gas Transmission Corporation under that [fol. 9874] plan and to provide benefits which have been determined should be provided for them is $30,000. We have obligated ourselves not only to the insurance company but to the employees as well, as to this particular matter. Now, when I say obligated, I am not speaking for the Board of Directors. This amount has yet to be approved by the board but I have no doubt that it will be approved.

Q. The plan is just to put the employees of Michigan Gas Transmission Corporation on a par with the employees of Panhandle Eastern and its subsidiaries, that is correct, is it not?

A. Substantially on a par. We bring them under the same umbrella and we will give them the same protection that employees of Panhandle Eastern may receive in the future.

Mr. Lee: Is that in addition to the Social Security benefits they receive?

The Witness: Yes, sir.

Mr. Lee: What is the limit of earning to entitle an employee to come within it?

The Witness: May I rephrase your question, please? I think perhaps I can answer it better.

The group annuity plan of Panhandle Eastern, which is expected to be extended to Michigan Gas Transmission, is available to all employees.

Mr. Lee: Regardless of their earnings?

[fol. 9875] The Witness: That is right, but it is based on their earning power. It picks up an employee after a certain specified period of service and provides benefits for him on a certain basis up to the age of 40, and, after the age 40, on a different basis. It is the so-called non-contributory plan. The employees have no vested rights whatever prior to 15 years continuous service and do not have any vested rights whatever if they leave company employ prior to that time.

Mr. Lee: As I understand it, everybody working for Panhandle Eastern, regardless of whether they earn $2,000 a year or $40,000 a year, gets a pension in addition to Social Security benefits, to which the employee makes no contribution. The rate payer pays the whole shot, is that right?

The Witness: I would not say that they get a pension, Mr. Lee, but one is being provided, an indefinite amount payable at some indeterminate time in the future.

Mr. Lee: Regardless of the earning power of the employee?

The Witness: There is a limit to the total amount of pension, if that is what you are getting at.

Mr. Lee: What I want to get at is, an employee earning $8,000, $9,000, $10,000, or $40,000 is a beneficiary without making any contribution?

The Witness: That is right.

Mr. Lee: It is all saddled on the rate payer?

The Witness: I do not know whether it is saddled on [fol. 9876] him or not but it is a part of the company's legitimate expenses.

Mr. Lee: Does the employee make any contribution toward it?

The Witness: It is a non-contributory plan.

Mr. Lee: What does it cost the rate payer to carry this system a year?

The Witness: If you will look at Exhibit No. 190, I believe it is, you will find some information with respect to that, opposite lines 12 and 13.

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[fol. 9878] By Mr. Culton:

Q. Will you please explain No. 248?

A. Exhibit No. 248 is a pro forma consolidated income account for the year ending December 31, 1941, for Panhandle Eastern Pipe Line Company and subsidiary companies and, as shown by Note A, includes the activities of Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation, and is prepared on the basis that the financing of the cost of the acquisition of the outstanding stock and indebtedness of Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation resulted in annual interest costs of $300,000, and which has consummated on February 6, 1942, had been effected January 1, 1941, that the interest expense applicable to obligations of Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation to Columbia Gas and Electric Corporation, their then parent, would have aggregated the same amount had the Panhandle Eastern Pipe Line Company been the parent company and that dividends had been paid by Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation to the extent of their net income for the year and after giving effect to the estimated increases in Fed-[fol. 9879] eral income taxes, which would have resulted had such interest and dividends been paid by Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation, to Panhandle Eastern Pipe Line Company to the full extent of their net income and to the inclusion of certain authorized increased costs, not fully included in expense for the year 1941.

On that basis, the exhibit for identification No. 248 shows in Column E opposite Line No. 29, net income amounting to $5,342,361.60.

Q. Now, have you made a similar computation and prepared a similar consolidated account adjusted to give effect to the rates proposed in Secretary Morgenthau's recommendation? A. I have, sir.

Q. Is that Exhibit 249? A. It is.

Q. Will you please explain that exhibit?

A. Exhibit 249 for identification has been prepared in exactly the same manner as Exhibit No. 248 for identification, except that the amount of Federal income and excess profits tax used in Exhibit No. 249 are those based on the rates proposed in the recommendation of the Secretary of the Treasury Morgenthau on March 3, 1942, before the House Ways and Means Committee, and varies from Exhibit No. 248 for identification in that the net income shown in Column E of Exhibit for identification [fol. 9880] No. 249 opposite Line No. 29 is only $3,550,-590.72 as contrasted with $5,342,361.60 as shown in Column E, line 29, of Exhibit No. 248.

Q. A difference of how much? Will you make a computation? A. $1,791,770.88.

Q. Was this computation evidenced both by Exhibits 248 and 249? Did you take into consideration the increases in company expenditures reflected in Exhibit 247?

A. I did, yes, sir.

Q. Now, will you explain Exhibit 250?

A. Exhibit 250 for identification is a statement of rate case expenses in connection with Federal Power Commission consolidated dockets Nos. G200 and 207, which includes actual cost to February 28, 1942, and estimated cost to complete. It shows in Column A the nature of the expense, in Column B the actual expense incurred to February 28, 1942, estimated cost to complete in Column C, and the total cost in Column D. The actual cost to February 28, 1942, as shown by a long line 13 of Column B is $214,898.95, estimated cost to complete, as shown on Line 13, in Column C is $135,101.05, with a total cost in Column D opposite line 3, of $350,000.

There were at February 28, 1942, certain costs incurred that had not yet been submitted to the company. Those [fol. 9881] costs are included in the estimate shown in Column C. The amount shown opposite the general heading such as "Engineering" includes both fees and traveling expenses.

Traveling expense has been a rather important item in this proceeding.

Q. That is largely due to the circumstance that the hearings will be held at a considerable distance from where the company's offices are and where the witnesses reside? A. That is true, yes, sir.

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Mr. Littman: Mr. Watkins, the figures that appear in Column B of Exhibit 250 represent the amount actually paid to February 28, 1942?

The Witness: Column B?

Mr. Littman: Yes.

The Witness: Mr. Littman, they were either paid or in the process of being paid. Now, our accounting routine is such that if we get a statement prior to the closing of, shall we say, February work, we will actually record that in February work, although our payment might not necessarily be completed until some time during the month of March. Do you understand that, sir?

Mr. Littman: Yes, sir.

The Witness: So that the expenses actually incurred for which statements have been presented, although I [fol. 9882] shouldn't feel it proper for me to say they actually had been paid prior to the 28th of February, because some of them, no doubt, were in the process of payment during the early part of March. There is no duplication between the amount shown in Column B and Column C, however.

Trial Examiner: I assume this statement of rate case expenses includes a proration of salary employees' time.

* * * * * * * *

The Witness: No, sir, it does not.

Trial Examiner: So that it does not include any charge for the time of yourself and others who are on these companies' payrolls?

The Witness: That is correct, sir, except to the extent that any overtime incurred by the rank and file, or where it became necessary to employ additional employees, that amount is shown opposite Line No. 7, under the general

heading "Overtime and Additional Employees," but there is no portion of the general salaries of official force or the department heads or the staff, generally, even when they were employed in overtime work, of which there has been a tremendous amount in connection with this matter.

Trial Examiner: To that extent, then, your statement of rate case cost is inadequate and incomplete?

[fol. 9883] The Witness: That is quite true, sir.

By Mr. Culton:

Q. This item of overtime and additional employees: has any of that been charged as a part of regular operating expense?

A. No, sir, no part of it. I want to be clearly understood with respect to that. The additional employees were employees engaged, not to do the work of the regular force who were working on exhibits, and so forth, for presentation, but they were additional employees brought in for the purpose of preparing material for this particular matter.

We had quite a number of artists, for instance, to work on a great number of the maps and so forth prepared during the early stages.

Now, the overtime portion shown opposite No. 7 is the overtime of certain of the staff, the rank and file, in such instances that they had to perform overtime services to keep up with their regular work, and when I say "keep up," that is correct, because we haven't been able to keep up with our regular work, by a great deal.

Trial Examiner: Have you kept records to enable you now to prorate the salaried expense which was necessarily incurred in the rate case matters?

The Witness: I am sorry, sir, we have not.

Trial Examiner: Have you any intention to make such [fol. 9884] a proration?

The Witness: As far as this witness knows, the company has no such intention, sir.

Trial Examiner: Although it is a large sum?

The Witness: There is no question of that, sir. It is a tremendous sum.

Mr. Littman: Those amounts are included in your regular operating expenses for the year 1941, are they not?

The Witness: Yes, that is quite correct.

Mr. Littman: Do I understand that none of the months shown in Exhibit 250 are duplicated or included in any of the operating expenses of the companies as shown on their books for 1941?

The Witness: I don't know how we could indicate them, Mr. Littman, and have our books in balance.

Mr. Littman: I merely wanted the record to be clear on it. I understood you to say that these were over and above the—

The Witness: There is no duplication.

Mr. Littman: That is, these were all carried in the deferred account for a time, or most of them?

The Witness: Yes, a specific work order in which we have gathered the expenses incident to these proceedings. Charges made to that work order have not been distributed to regular expense accounts.

[fol. 9885] Mr. Littman: And in so far as your employees did work from time to time on various phases of this rate case, the amounts expended in that connection would, of course, be included in the regular expenses?

The Witness: Well, it could be, Mr. Littman, that in a very few instances we may have taken a few employees, a very few, and assigned them specifically to the preparation of material for the rate case, in which event their salaries would have been charged on the work order from which the information shown in Column B of Exhibit for identification 250—but I don't remember any of them, any such employees, any such segregation.

Trial Examiner: What is the fact as to the method of charging the expense accounts of salaried employees who have been engaged in this proceeding?

The Witness: As to whether or not there has been any change, sir?

Trial Examiner: As to whether or not they have been charged to operating costs or segregated to the account of the rate proceeding?

The Witness: Only to the extent that employees have incurred overtime.

Mr. Culton: I think the Examiner has reference to expenses to Washington, for example.

Trial Examiner: I stated traveling expenses.

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[fol. 9886] The Witness: Any traveling expense incurred specifically in connection with this rate proceeding has been charged to the deferred account from which these costs that we now have before us in 251 was accumulated.

Mr. Littman: In other words, they are included in Exhibit 251?

The Witness: If they could clearly be shown as being such expenses. Now, some of us officers have to jump hither and yon on different occasions, and so forth, and it could very well be that some of our expenses have not even gotten in here.

Mr. Littman: Mr. Watkins, I would like to have you furnish for the record an itemized statement of these rate case expenses, showing the amounts and the individuals to whom they were paid. Could you do that for us?

* * * * * * * *

The Witness: How long do we have for the development of that information, sir?

Mr. Littman: How long would it take?

[fol. 9887] The Witness: Possibly a week, ten days, maybe two weeks.

Mr. Littman: Let me suggest, then, that we reserve as Exhibit No. 250-A, a place for this supplemental exhibit to

be inserted when it is received by the Commission, even though it may be received after the hearings on this phase of the proceeding be closed.

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Trial Examiner: I think that is an entirely satisfactory arrangement, and I think it is much preferable to let certain supplemental data, which may be required, come in after the completion of the hearings.

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[fol. 9889] Mr. Culton: Mr. Examiner, some time back we were requested to produce a letter written by Mr. P. McDonald Biddison to Mr. J. D. Creveling relative to the purchase of the various properties from Columbia Gas and Electric Corporation and Ohio Fuel Gas Company. This is the letter, isn't it, Mr. Watkins?

[fol. 9890] The Witness: Yes, sir, that is an executed counterpart of the letter.

Mr. Culton: We ask that it be incorporated in the transcript, and we understand that counsel has no objection.

Mr. Littman: No objection.

Trial Examiner: Very well, it may come in at this point.

(The letter lasts above referred to reads as follows:

"Washington, D. C.,
"November 24, 1941.

"Mr. J. D. Creveling, President,
"Panhandle Eastern Pipe Line Company,
"90 Broad Street,
"New York, N. Y.

"Dear Sir: Since your inquiry to me on November 13, 1941, I have secured and examined data on the property presently proposed to be acquired by Panhandle Eastern Pipe Line Company from Columbia Gas and Electric Corporation and The Ohio Fuel Gas Company, those properties and the approximate purchase prices being:

	Approximate proposed Purchase Price
Stock and Debt of Michigan Gas Transportation Corporation	$10,700,000
Stock and Debt of Indiana Gas Distributing [fol. 9891] Corporation	145,000
Certain Properties of The Ohio Fuel Gas Company including: Line Z50 from its intersection with Line Z58 to King Station (Indiana), approximately 32.825 miles of 16". Line Z58 from its intersection with Line Z50 across Ohio-Indiana State line to its end at a point near Richmond, Inc., approximately 12,808 miles of 10". Line Z72 from its intersection with Line Z59 to its end at Winchester, Indiana, approximately 7.187 miles of 6" and 6⅝". Together with Measuring Station Structures designated as King, Western-Lynn, Western-Hollandsburg, Western-New Paris, and Measuring Station Equipment and their connections to the foregoing lines designated as Western-Lynn, General Glass, Ohio-Indiana, Indiana Central Natural, State Line, Western-Hollandsburg, Western-New Paris	440,000
Total	$11,285,000

It is my opinion that the proposed purchase prices are fair prices for Panhandle Eastern Pipe Line Company to pay for these properties.

(Signed) P. McDONALD BIDDISON,
Consulting Engineer."

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[fol. 9893] Recross Examination

By Mr. Littman:

Q. Mr. Watkins, I want to ask you a few questions about a matter that we have discussed on the record heretofore, relating to certain rate schedules that were forwarded to this Commission for filing, but which have not as yet been approved by the Commission.

You recall, do you not, numerous references to those matters?

A. I certainly do.

Q. Can you state whether it is a fact that if those numerous rate schedules which have been forwarded for filing with this Commission, and which have not yet become effective, had been in effect when forwarded to the Commission for filing in 1941, whether the revenues derived from those sales under those schedules would have been any different or would have been substantially differ- [fol. 9894] ent from those actually derived under the present schedules. Do you follow my question?

A. That is a rather broad question for me to answer, Mr. Littman, without referring to that entire file which is probably, by this time, more than an inch thick, but if I may answer it in a general way, if that proves satisfactory, perhaps we can dispose of the question that seems to be bothering you at the moment.

My present recollection is that had those filings been in effect during 1941—is that the period that your question was directed to?

Q. Yes, that is when they were filed.

A. Had they become effective in the ordinary and customary routine after their filing in 1941, there would not have been a very great difference in the amount of revenue that Panhandle Eastern received.

There was some slight change anticipated, statements of all of which are in the possession of the Commission with that tremendous bulk of stuff that has been filed concerning those matters.

My remembrance is there is an individual statement for each individual portion of those filings, that shows what the anticipated effect for the next calendar year might be, and that that has been filed quite some time, and, [fol. 9895] as my memory goes at the moment, the very last thing we have from the Commission formally concerning these matters is an acknowledgment of the receipt of that material, and stating they would take it under advisement.

Q. In other words, it is our best recollection at this time that had these proposed rate schedules been in effect in the year 1941, as filed, there would have resulted no substantial difference or change in revenue to Panhandle Eastern.

A. That is my present recollection. I take it that Counsel's question—and I am certain the witness' answer—assumes that exactly the same quantity of gas would have been purchased.

Mr. Littman: Yes indeed.

Just one moment.

Mr. Culton: Let me ask this and see if I am correct.

By Mr. Culton:

Q. Those contracts were merely changed in form for receiving the same volume of money, were they not?

A. That is true, Mr. Culton. If we look at the matter from the standpoint of Panhandle Eastern before ownership of Michigan Gas Transmission Corporation, there was probably a very slight differential in favor of Panhandle Eastern, but since the ownership of Michigan Gas Transmission is now vested in Panhandle Eastern, the differential would have washed out in consolidation.

[fol. 9896] Q. On a consolidated income account, there would have been no difference whatever?

A. Assuming the same exact quantities of gas purchased. That is my present recollection.

By Mr. Littman:

Q. Mr. Watkins, you, I presume, had some considerable part to play in the preparation of the supplemental information attached to the prospectus of Panhandle Eastern Pipe Line Company here identified as Exhibit No. 233, did you not?

A. I am afraid I did not.

Q. Did you have anything to do with it at all?

A. About all I had to do with the supplemental information shown on page 53 was to take care of the mechanical work involved in having it inserted in the proper place in the prospectus and seeing that the various distributing bodies who had reason to distribute the prospectus were supplied with their required number of copies for dis-

tribution. I had nothing whatever to do with the preparation of that material nor with the preparation of the material shown on the front cover under date of April 2.

Q. I have not had time as yet to go through this prospectus, Exhibit No. 233, but I will ask you whether there is anything contained in this exhibit or the supplemental in-
[fol. 9897] formation contained therein which speaks as of approximately April 2, 1942, whether Exhibit 233 makes any statement regarding the effect upon the business of Panhandle Eastern and subsidiary companies by reason of War Production Board Order No. L-31.

A. If the witness remembers your statement correctly, it was directed to a date of April 2, 1942. I don't believe you quite meant that, did you? Is your question directed to the prospectus as a whole or to the rider attached on the cover sheet and the rider attached to page 53.

Q. The rider attached to the first page is dated April 2, 1942, and the rider attached to page 53 is dated April 4, 1942.

A. And those are the two items to which your question refers?

Q. Yes.

A. There doesn't seem to be anything in either of those referring to L-31.

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[fol. 9898] C. H. M. Burnham a witness heretofore duly sworn, resumed the stand, and was examined and testified as follows:

Cross-Examination.

By Mr. Littman:

Q. Mr. Burnham, define the term "capacity" as you have used it in Exhibits Nos. 229 to 231, inclusive.

A. Capacity, as used in those three exhibits refers to the ability of the pipe line system to make those deliveries as specified day in and day out. When I say "deliveries" I mean deliveries at the sales points. Which deliveries total to the quantity shown on the various studies.

Q. That is, the ability to deliver day in and day out, the amount of 338,000 M. c. f., as shown on Exhibits 230 and 231, and 307,000 M. c. f., as shown in Exhibit 229; is that right? A. That is right.

Q. Now, do you mean by that, the ability to make those [fol. 9899] deliveries with or without the standby equipment which is set forth on the fifth page of each of Exhibits 229, 230, and 231?

A. At normal load factors, those deliveries can be made without the standby equipment shown on the last page of each exhibit.

Q. And what do you mean by "normal load factors"?

A. Load factors approximating 70 percent.

Q. What was the load factor of the Panhandle Eastern System during the year 1941?

A. It was, to the best of my information, very nearly 67 percent.

Q. Mr. Burnham, I have just one more question. Will you please define the term, "firm basis" as you have used it in Exhibits 220, 230, and 231?

A. Firm basis used in that connection means after having interrupted readily interruptible sales.

Q. Isn't there some little discrepancy between your definition of that term, as just given, and certain responses to some of Mr. Lee's inquiries this morning. If there are any, and I think the record could be clearer, I wish you would explain.

A. I don't believe there is any discrepancy. What it really amounts to is this: that all our special and industrial sales are made on an interruptible basis. That is, the [fol. 9900] contracts specify that these sales may be interruptible in the event of a shortage of gas for domestic customers.

Q. Just right there, if I may interrupt. All industrial sales are—

A. (Interposing) Special industrial sales.

Q. All special industrial sales are contracted on an interruptible basis.

A. That is correct.

Q. What do you mean by special?

A. Well, the pipe line company make direct contracts with industrial customers. We call those, of course, special industrial contracts. Some of the distributing companies make two kinds of contracts with industrial customers. One of them which involves the interruptible clause and another which might be sold on a firm basis.

Q. Now, are those differentiated as between special and not special, the latter class?

A. Well, those that are brought to us for clearance, and to determine whether we have sufficient quantities of gas to supply the proposed industrial customer, are named special industrial.

Q. Those are ones that are made at a kind of special price, too?

A. Well, I think the rate filings specify the prices, if [fol. 9901] I am not mistaken. At least, the filings that we have with the Commission specify the division of the revenue obtained from that sale.

Q. Well, the firm industrials—that is, the noninterruptible industrial sales, are, of course, at a higher rate than the interruptible customers?

A. That is correct.

Q. Now, as I understand your testimony, all of the direct sales—that is, the sales made directly without the intervention of a distributing company—that is, sales made directly to industrials by Panhandle Eastern, are made at all times on an interruptible basis?

A. That is correct.

Q. Do the sales which you show, for instance, in Exhibit 229, page 1, include any sales to interruptible customers or to customers that you have designated as "special industrials"?

A. The fact of the matter is that total quantity of sales on that page and, in fact, on the first page of the other three exhibits—

Q. (Interposing) Of the other two exhibits.

A. (Continuing) —of the other two exhibits.

Q. Exhibits 230 and 231?

A. Yes. (Continuing) —does not specify the distribution of this gas whatever. As I testified yesterday, I was [fol. 9902] handed a problem to determine how much gas a completely looped system with the present power would be capable of handling or delivering on the peak day, and I was also given the problem to determine the maximum capacity that might be developed if we fully powered a completely looped system. So these quantities of gas shown here, as the delivery capacity don't necessarily allocate this gas to any one customer.

Q. In other words, not necessarily to firm customer?

A. That is right.

Q. In other words, these are the deliveries that you could make on a peak day if you had the capital additions which you have estimated in these exhibits?

A. That is correct.

Q And could make every other day?

A. Yes.

* * * * * * * *

By Mr. Lee:

Q. Do I understand that your present average load is 67 percent, did you say?

[fol. 9903] A. I made a rough calculation the other day and I think it came out 67 percent load factor.

Q. Now, then, these exhibits that Mr. Littman has just been interrogating you about, they contemplate a 90 percent load factor.

A. Mr. Hinton persented some exhibits which contemplated a capacity factor as high as 90 percent.

Q. Well, now, the idea I wanted to get straightened out in my mind is this: your exhibits presented here today, contemplated the same as Mr. Hinton, a 90 percent daily load factor.

A. My exhibits do not contemplate any load factor. They are merely to show the investment required and the tons of pipe required to meet certain peak day deliveries.

Q. But it isn't peak day, it is to maintain every day a certain amount of delivery.

A. Yes, the calculations are so carried out that if it will meet one day, it will meet several days.

Q. Yes, that is right, but what will be the load factor on the then existing system?

A. If you ran at the same capacity every day, it would be a hundred percent load factor.

Q. That is what I am getting at.

So you have presented exhibits here that contemplate [fol. 9904] an increase from an average of 67 percent load factor, as it is today, to a 100 percent load factor?

A. No, not necessarily.

Q. Why not?

A. My exhibits have nothing to do with load factor.

Q. I understand, but you agree, don't you, that under the hypothesis you have set up, a daily delivery of a fixed

amount under the augmented increased system, under the expenditure you proposed, would mean a 100 percent load factor?

A. If you delivered the same quantity of gas every day, then or now or last year, it would have been a 100 percent load factor.

Q. And that is what you contemplate under these exhibits, don't you? A daily delivery of a fixed amount?

A. I don't know what you exactly mean by that, but we do design for a daily delivery of a fixed amount on a continuous basis.

Q. Exactly. And that, in the last analysis, would mean a 100 percent load factor, wouldn't it?

A. If it were experienced, it would result in a 100 percent load factor.

Q. Certainly. It is all assumption, anyhow, but if the supposition were carried out, it would be a hundred percent load factor, and you contemplate a situation, as I understand it, your proposed expenditures and increased [fol. 9905] capacity, to accomplish what is set forth in the exhibit, practically one-third increase over your present plant and facilities; is that right?

A. I contemplate a design which would be capable of handling considerably more gas than we now handle, and considerably more gas than we have handled, on a lesser capacity factor.

Q. Yes; but measuring on a low factor basis, it would be a 1/3 increase, the difference between 67 and 100 percent, wouldn't it?

A. I would call that a 50 percent increase in load factor.

Q. Difference between 67 percent and 100 percent?

A. Yes.

Q. Well, 67 out of a hundred is 2/3.

A. And 1/3 is exactly 50 percent of 2/3. 1/3 increase would be a 50 percent increase.

Q. That is right. So you contemplate an expenditure that will double your facilities? is that right?

A. Your word "contemplate" bothers me.

Q. You use your own wording. That is what it amounts to, doesn't it?

A. We have set forth here estimated expenditures which, if incorporated in our plant account, would be

capable of developing capacities that I have shown on these [fol. 9906] three studies, and if the 338,000,000 were carried on a continuous basis, each and every day of the year, namely, on a 100 percent capacity factor, naturally our capacity factor or load factor would be increased approximately 50 percent.

Q. Now, you don't set it forth just as a theory or a possibility, you set it forth as what you say you should have in order to get the return to enable you to make the expenditures to get that; isn't that your purpose here?

A. I haven't testified a word about return.

Q. I know you haven't. You have carefully avoided that. You haven't told us anything about that, but you do seriously come here as a witness and you seriously make this proposal because you seriously say that is what you should have and that is the amount of money you need to create it.

A. That is correct.

Q. Yes, that is right, that is your purpose here, isn't it?

A. I am serious about this matter, if that is what you want to know.

Q. And yet, while you are serious about it, you don't for one minute think that you are going to be able within in next year or two, in view of the conditions that obtain, in getting material, you don't think, really, now, seriously and honestly and in an ordinary common sense method, [fol. 9907] that you are ever going to achieve it, do you?

A. We are getting materials right today for carrying out a lot of our projects.

* * * * * * * *

Trial Examiner: Mr. Burnham, coming back to your exhibits 226 and 227, to which Mr. Lee has just referred, or you, in your answer. Have you those exhibits before you?

* * * * * * * *

[fol. 9908] The Witness: Those were Mr. Hinton's exhibits, aren't they?

Trial Examiner: Yes, they are.

The last two lines of the captions of those exhibits are unpunctuated, and read, in one instance: 307,000 M.c.f. continuous daily sales capacity operation at 90 percent capacity factor, and 227 is 338,000 M.c.f. at 70 percent capacity factor.

The Witness: That is correct.

Trial Examiner: Is it necessary to punctuate those two lines at any point with a comma to make them accurate?

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Mr. Culton: I am just about old fashioned enough, like the Examiner, to believe in a comma after that first word "capacity."

Trial Examiner: All right. That is where you would set your comma?

Mr. Culton: Yes, sir.

Trial Examiner: After the word "capacity"?

Mr. Culton: I know they don't use commas any more like they used to.

[fol. 9909] Trial Examiner: Would you agree with Mr. Culton that the placing of the comma in those two lines might affect the meaning?

The Witness: I don't know that it would affect the meaning, but I think it clarifies it.

[fol. 9910] Trial Examiner: One more question: After you have used the first line, how do you affect the meaning by adding the second line of the words which I have just quoted?

The Witness: Well, as Mr. Hinton testified, to get annual volumes, why, the second line is the determining thing. Annual volume sold.

Trial Examiner: That is, on the assumption that you will be unable at any time to operate continuously at 100 per cent capacity?

The Witness: The assumption, in the case of 226, is that it will be operated at 90 per cent of maximum capa-

city. The average day would be 90 per cent of maximum capacity.

Trial Examiner: When you have stated your pipe capacity at maximum, is that, in the case of Exhibit 226 307,000 M.c.f. each day in the year? Is that what you are talking about: a capacity to deliver continuously, day after day, 307,000 M.c.f. every day in the year?

The Witness: That is the capacity.

Trial Examiner: That is your maximum capacity?

The Witness: That is right.

Trial Examiner: Now, your second line, then, assumes that capacity and also assumes a market limitation, or, in other words, assumes that the market will absorb only 70 per cent of that capacity: is that right?

The Witness: In the case of 227?

[fol. 9911] Trial Examiner: In the case of exhibit for identification 226, page 1.

The Witness: 226 specifies 90 per cent. I beg your pardon, sir.

Trial Examiner: I beg your pardon also.

Mr. Littman: Of course, exhibits 225 and 226 are referring to operations and maintenance expenses, as distinguished from capital expenditures on pipe lines, wells, and so forth.

Trial Examiner: Yes, I understand, but we are referring only now to the contemplated service, to the contemplated capacity of the pipe line, which is stated in this phrase—

Mr. Littman: (Interposing) Contemplated use, as I understand it.

Trial Examiner: Very well.

Mr. Littman: Not contemplated capacity.

Trial Examiner: I simply want to get straight on some of these phrases that are being used and to know what is meant and what the effect is of assuming a maximum de-

livery, a maximum possible delivery, and then a maximum sales outlet, so to speak.

Mr. Culton: There is this distinction, I think, Mr. Examiner: I am not an engineer, but these engineers present may bear me out.

Note the use of the word "capacity factor" here, rather [fol. 9912] than load factor.

Load factor, as I understand it, is the average day to the highest day of a sale to a customer, for instance: is that correct, Mr. Burnham?

The Witness: Yes.

Mr. Culton: Whereas this deals with capacity factor. In other words it would be the relationship of the average day to the absolute capacity of the line: is that correct, Mr. Burnham?

The Witness: That is correct.

Mr. Culton: So that there is some difference between load factor, with respect to a particular customer, and capacity factor with respect to the line as a whole.

Mr Littman: As a matter of fact, very frequently engineers use the term "load factor" when they refer to what you call "capacity factor" here?

The Witness: Sometimes it is loosely referred to by either term.

Trial Examiner: Well, your prospective betterments are intended to provide—

The Witness: (Interposing) Certain maximum capacities.

Trial Examiner: (continuing) —Certain maximum capacities.

Now, your operating expense depends on how much you actually handle?

[fol. 9913] The Witness: Correct.

Trial Examiner: Capital investment is determined by the capacity provided?

The Witness: Correct.

Trial Examiner: And your operating expense accounts in contemplation depend on the accuracy of your estimates of use, actual sales?

The Witness: Correct.

Trial Examiner: May I ask Mr. Watkins a question?

Mr. Culton: Yes.

Trial Examiner: You have used, in several of your exhibits, including the last one you submitted, the words "pro forma".

Will you please define those for the record, Mr. Watkins?

Mr. Watkins: Well, sir, those words bothered your witness as much as they apparently bothered the Trial Examiner. Where those words were used in connection with any of the exhibits that have been introduced through this witness it was the intent to show by means of tables the conditions that would have existed had the circumstances explained by the notes in those exhibits, or made a part of them, been present throughout the entire period.

I don't know whether that is sufficiently clear to you or not, sir.

[fol. 9914] Trial Examiner: Is it fair to infer from that statement that in every case where you have attached the words "pro forma" to some exhibit, that in part it is hypothetical or based upon assumed facts, the existence of which you do not guarantee?

Mr. Watkins: I would rather we would relate it to the latter part of your suggestion, sir, rather than the thinking of it in the nature of something that is hypothetical.

It is, if we may put it this way, a combination of information or facts extracted from the books and records of the companies combining certain conditions that are now present, but which were not present, in whole, in the books and records for the periods for which the ex-

hibits have been prepared, and includes, in addition to that, certain adjustments made, based on, for instance, the recommendations or proposal by the Secretary of Treasury of March 3, 1942, with respect to the revenue for 1942.

They purport to show, for Panhandle Eastern and its subsidiary companies as those companies now exist, what would have been the material that would have been included in similar exhibits had it been possible to prepare such exhibits under such conditions.

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[fol. 9916] Mr. Littman: Mr. Burnham, you will recall that when you first took the witness stand and were first cross-examined by me, I made a number of requests asking that you furnish certain data and information: do you recall that?

The Witness: Yes, I recall that.

By Mr. Littman:

Q. I hand you a document entitled "Panhandle Eastern Pipe Line Company and subsidiary companies—additional information requested in re Exhibit No. 17," and ask you whether this was prepared by you in response to my numerous requests which were in connection with your exhibit No. 17.

A. Yes, prepared by me and with the help of various departments and members of the organization in Kansas City.

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(The document referred to was marked for identification as Exhibit No. 252.)

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[fol. 9918] (The Document Referred to Was Received in Evidence as Exhibit No. 252.)

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Redirect Examination

By Mr. Culton:

Q. Mr. Burnham, you were asked about the meaning of some words.

What were you referring to in the use of the words "continuous daily capacity"?

A. One might infer that to mean day after day, but from a practical standpoint that means a period of 15 or 20 days, I would say, from a standpoint of pipe line operation.

Q. Why is that?

A. Well, it would be physically impossible to operate a system at the same load every day, particularly if there are no standby units provided in that system.

[fol. 9919] Q. In order to operate continuously on any of the bases which you have mentioned it would be necessary for you to have this additional standby equipment which you referred to: is that correct?

A. Indeed it would.

Q. If you operated the system at the present 250 million continuously, would it be necessary to have that same standby equipment?

A. Yes, it would.

Q. Do you know whether any of the pipe line companies do keep standby equipment available where the loads are high load factors, or high capacity factors?

A. Certain pipe line companies differ with the policy established by Panhandle Eastern Pipe Line Company in the matter of standby units.

The Panhandle Eastern Pipe Line Company, to date, has not adopted the policy that it should have a standby unit in every station.

It believes in properly maintaining these units and having them ready for any long, hard pull, such as might occur over a week or ten days.

Other companies, as I have just indicated, do sometimes provide an extra unit which is always available in case of a breakdown.

Now, as I mentioned a while ago, it would be physically [fol. 9920] impossible to operate at a hundred per cent capacity factor under any condition.

That would infer exactly the same quantity of gas each and every day. Such things do not happen.

Q. It is really rated capacity, then, when you refer to a hundred per cent capacity, isn't it, whether it is actual practical capacity or not?

A. That would be one way of terming it, so, as one increases his capacity factor, the need for standby units becomes greater and greater, until a capacity factor, as I testified yesterday, of something like 90 per cent makes it practically necessary that each and every compressor station be provided with a standby unit.

Now, there are other considerations, too, which would indicate whether or not a standby unit should be provided, and I have in mind, on the Michigan Gas Transmission System, the compressor station which is the first station west of Detroit, Edgerton compressor station; it consists now of five 1300-horsepower Cooper-Bessemer gas compressor units, with the necessary appurtenant equipment.

If, on a cold day, during which period the load would be at or near peak requirements, if one of those engines should fail for some reason, it is apparent that one fifth of the available capacity at Edgerton compressor station would be made unavailable for that period.

[fol. 9921] We have given some consideration, and are now studying, whether or not a compressor station as near the market, or as near our largest market, as is Edgerton compressor station, should not have a standby compressor unit, even under the present load factor.

Trial Examiner: All right. You stated the theory. Now in the last year how many engines have failed in service?

The Witness: I recall just during this last winter, during that very cold weather, we had one or two failures west of Illinois.

I can recall specifically one which occurred in, I think, Haven or Greensburg compressor station, during the very cold snap that we had, or during peak load conditions. That particular engine was down only an hour and a half. We were fortunate in being able to make the repairs rather quickly.

Trial Examiner: It didn't actually affect your service at all?

The Witness: Being that far west we were able to repair it, get it back on the line, without having felt the drop in pressure that would occur had it been near the market.

Trial Examiner: How many have you had in the last five years that you know of for sure?

The Witness: I can't testify as to that, because—

[fol. 9922] Trial Examiner (interposing): Well, quite a number, or just an occasional failure?

The Witness: I would say quite a number. These engines will wear out valves, they will get hot bearings, and they will do this and do that.

Trial Examiner: Knowing the Panhandle System as you do and its future program, what margin of safety do you figure is necessary in the long run?

The Witness: As I just indicated a moment ago we have no margin of safety, in so far as extra units are concerned.

Trial Examiner: What do you figure is necessary in percentage when you are talking about per cent capacity?

The Witness: If the load factor or capacity factor should increase substantially above 75 or 80 per cent, I would say that the factor of safety, in that event, should be increased by installing a standby unit.

By Mr. Culton:

Q. Do you have some safety now under present conditions during portions of the year?

A. As I just mentioned a moment ago, we run all compressor units on the coldest day, and we have no standby units.

Q. The Examiner, I think, probably had in mind a while ago whether there was an actual failure or not, teardowns. What has been the practice in tearing down and rebuilding the engines, whether there was a failure or not?

[fol. 9923] Trial Examiner: I was just referring to the practical fact of the liability to failures.

Mr. Culton: I see.

Trial Examiner: And the final question is perhaps this: When you provided this standby power in reserve, how much margin of safety do you then figure necessary?

In other words, how nearly are you sure to supply the maximum capacity, if you can sell it?

The Witness: Well, if you had a standby unit in each compressor station it would be a very unusual circumstance if you had more than one unit go down in any one station at a time.

Trial Examiner: When you have reached that point, then you are able to go one hundred per cent, if you could sell the gas?

The Witness: I would say you would be able to go one hundred percent under those conditions.

Trial Examiner: If you had it for sale and you were able to sell it?

The Witness: That is correct.

By Mr. Culton:

Q. Has it been the custom to rebuild your units during the summer?

A. Yes.

[fol. 9924] Q. Tear them down and work them over so as to have them ready for the winter run?

A. That is the only time that we have to recondition our units, inasmuch as they are all operating in the winter time.

Q. But if you had additional units you could be reconditioning all during the year, is that it?

A. That is correct.

Recross Examination.

By Mr. Littman:

Q. You said a moment ago that you had no margin of safety on your system.

Isn't is a fact that your interruptible industrial customers furnish a margin of safety?

A. Well, I was contemplating an operation at 100 per cent capacity at that moment. There is no margin of safety when you are operating at 100 per cent capacity.

Q. But I believe you said "under the present conditions," did you not?

In other words, we don't want any misunderstanding in the record with respect to the matter.

There isn't any question, is there, but what your interruptible customers do furnish a margin of safety, do they not?

A. Well, provided they can be interrupted, yes, and [fol. 9925] there is no question about it.

Q. Your contracts so provide, do they not?

A. Did you not mention a while ago that W. P. B. might order us to supply these interruptible customers, even though the contract specified otherwise?

Q. Yes, but you are still going to have some interruptible customers that aren't engaged, necessarily, in defense work, aren't you?

A. In the future or in the past, now, are you talking about?

Q. Well, let's take the past first.

A. Yes, we did have.

Q. You did have a certain margin of safety by reason of your interruptibles?

A. Yes.

Q. And let's put it this way: To the extent that you will have interruptible customers in the future you will have a margin of safety?

A. To the extent that they can be interrupted.

Q. Very well. Now, you also made some reference to the installation of an additional unit for the Edgerton compressor station, which is the last point of compression before Detroit.

Isn't one of the reasons why you might need that the fact that there is a variation in hourly take by Detroit?

[fol. 9926] A. Yes, that is another consideration that I did not mention.

However, the contract with Detroit specifies that that company should, to be best of its ability, although I am not quoting the contract, level off the hourly peaks with its holder equipment.

Q. As a practical matter has that been done?

A. I do not know.

Q. You have made no study of the hourly takes?

A. No. We have only recently assumed control of Michigan Gas Transmission, and for that reason it has not been given much study.

Q. But you do know that there is an hourly variation, do you not?

A. Indeed there is.

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[fol. 9928] LEONARD SPACEK was called as a witness, being first duly sworn, was examined and testified as follows:

Mr. Culton: Mr. Examiner, this witness will testify with respect to Exhibit 251 which has already been marked for identification, I believe, this morning.

Direct Examination.

By Mr. Culton:

Q. Will you please state your name to the reporter?

A. Leonard Spacek.

Q. What is your profession?

A. Public accounting.

* * * * * * * *

By Mr. Culton:

Q. Where do you live and with what firm are you con-[fol. 9929] nected at this time, and in what capacity?

A. I live at 415 Laurel Avenue, Wilmette, Illinois. I am a partner of the firm of Arthur Anderson and Company.

Q. What is their business?

A. Public accountants, with offices in Chicago, New York, and twelve other cities in the United States.

Q. How long have you been associated with Arthur Anderson and Company?

A. I have been with Arthur Anderson and Company since 1928.

Q. And how long have you been a member of the firm?

A. Since 1940.

Q. Now will you state your education, training, and experience as an accountant?

A. I received my education in local schools and a college at Cedar Rapids, Iowa.

I took special courses at the University of Chicago, and took an accounting course at the Walton School of Commerce.

I became associated with Arthur Anderson and Company in 1928 as a junior accountant, and worked with that firm in various capacities until about 1935, and became accounting manager.

In 1940 I became a partner of the firm and am now in charge of all the public utility accounting work, of the firm, in the country.

[fol. 9930] Q. Have you done considerable accounting for various utility companies during that experience?

A. Yes, I have.

During that period I have audited, made several hundred audits, of public utility companies, and a few of our clients are:

The Southern California Edison Company.

The United Light & Power Company and its subsidiaries.

The Public Service Company of Indiana.

The Columbia Gas and Electric Corporation and its subsidiaries.

The Panhandle Eastern Pipe Line Company

The Northern Natural Gas Company.

The International Telephone and Telegraph Company.

The Commonwealth and Southern Corporation and its subsidiaries.

The Brooklyn Union Gas Company.

The Middle West Utilities Company.

We are also auditors for several public power projects, the lower Colorado River Authority at Austin, Texas; the Central Public Power District, Nebraska; South Carolina Power Authority; and several of the municipal electric utilities in the T. V. A. area.

[fol. 9931] Q. Over what period of time has your company been doing work for Panhandle Eastern Pipe Line Company?

A. I could not give you the exact date but it is from the beginning of that organization. I believe it is from the beginning of Panhandle Eastern Pipe Line Company when it was first organized.

Q. Have you been doing their work continuously since you have been with the firm of Arthur Andersen & Company?

A. Yes, sir. I might also add that I have been engaged on 15 or 20 rate proceedings, among which were the United Fuel Gas Company, where I represented or was in the employ of the City of Charleston; the Natural Gas Company of West Virginia, representing the company; United Air Lines Transport Corporation; the Commonwealth Edison Company of Chicago; Peoples Light, Gas and Coke Company, Chicago; the Chicago District Electric Generating Corporation, and the Chicago Motor Coach Company.

Q. Were you recently employed by Panhandle Eastern Pipe Line Company to make an investigation and prepare a statement showing the consolidated net operating revenue, pro forma, as adjusted for a full year's costs, as allocated between regulated and non-regulated sales for the year ended December 31, 1941? A. Yes.

Q. Is Exhibit No. 251 that document?

[fol. 9932] A. Exhibit No. 251 is that document and I might explain that the pro forma consolidated revenues and expenses for 1941, adjusted for a full year's costs, as appearing in Column (B) on that exhibit, represent the amounts which have been taken from the exhibits submitted in this proceeding by Mr. Watkins and agree with the results shown in particular on Exhibits 248 and 249.

I would like to incorporate those two particular references, on line 42 where it says, "(Exhibit)", it should be "(Exhibit 248)", which was identified this morning; and, on line 46, where it says, "(Exhibit)", it should be "(Exhibit 249)", which was identified this morning.

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Mr. Culton: So that counsel may all get their documents [fol. 9933] straight, let me state, on Exhibit No. 251, page

1, line 42, the figure "248" should follow the word "Exhibit" and lie within the parentheses. Is that right?

The Witness: That is correct.

Mr. Culton: Then, on line 46, the figure "249" should follow the word "Exhibit" and lie within the parentheses?

The Witness: That is right.

Mr. Culton: Then on page 6, in Note A, the last line, where it says, "shown in Exhibit ....", that should be filled in with the figures "247" so it reads "shown in Exhibit 247". Is that right?

The Witness: That is correct.

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By Mr. Culton:

Q. Mr. Spacek, in preparing your Exhibit No. 251, did you take the responsibility for the basis of allocation between regulated and non-regulated sales?

A. No, sir. I would like to point out that the heading of that column refers to Note B on page 6 which states that, "The basis of allocating revenues and revenue de- [fol. 9934] ductions between regulated and non-regulated sales is determined upon the opinions of the Independent Engineers", who, I understand, will follow me on the witness stand.

Q. Did you obtain, in addition to your consultation, did you obtain a written instruction from one of those engineers?

A. I received a confirmation of the conclusion reached on the basis of allocation in preparing this exhibit.

Q. You have that with you, do you, if anyone desires to see it? A. Yes, sir.

Q. Now, will you explain Exhibit No. 251?

A. I believe I explained the source of Column (B) and also the source of Column (C). The bases of allocation in Column (C) are explained on all the pages and I believe are more or less self-explanatory.

Columns (D) and (E) represent the percentages and the amount of Column (B), which applies to regulated sales, that is, the amount of operating revenue and operating

revenue deductions that are allocated to regulated sales on the basis of allocation explained in Column (C).

The amount in Column (F) shows a portion of the revenues and revenue deductions that apply to non-regulated sales, as those sales have been defined. The first section of page 1 shows the M. c. f. sales to the regulated and non-[fol. 9935] regulated classifications.

Q. After having made these allocations, did you arrive at a final allocation of the net operating revenues on the basis of the 1941 Federal income tax law?

A. Yes, sir.

Q. What was the total net operating revenue as reflected in Mr. Watkins' Exhibit No. 248?

A. The total net operating revenue reflected in Mr. Watkins' Exhibit 248 was $6,305,818.74.

Q. And on the basis of your allocation, how much of that operating revenue would be allocated to regulated sales?

A. 89.66 percent, or $5,654,052.04.

Q. And how much would be allocated to unregulated sales? A. $651,766.70.

Q. On the basis of Mr. Watkins' Exhibit No. 249, and using the recommendation of Secretary of Treasury for income and excess profits tax rates, what were the net operating revenues?

A. They were $4,514,047.86 for the company and its subsidiaries combined.

Q. But your allocation, how was that divided between regulated sales and non-regulated sales?

A. Of that amount, $4,038,053.88 was allocated to regulated sales, and $475,993.98 to non-regulated sales.

Q. Did you further, in your investigation, relate these [fol. 9936] various items to the Federal Power Commission's Classification of Accounts?

A. Yes. The following pages relate the total operation and maintenance, as appearing on line 25, to the classified accounts appearing in the Federal Power Commission's Uniform System of Accounts. That appears on pages 2 to 4, inclusive, of the exhibit, and, on page 5, the details of depreciation are shown as well as the amount of state, local, and miscellaneous Federal taxes, the last item in total appearing on line 36 of page 1.

Q. Then the Notes A and B shown on page 6 are explanatory of the method used by you in preparing this exhibit?

A. Yes, sir, and they apply to all pages of the exhibit.

Q. Yes. Based on the instructions given to you by Mr. Biddison and on the assumption that those instructions correctly reflect an appropriate allocation between regulated and non-regulated sales, do you think the matters reflected on Exhibit No. 251 are a correct reflection of the books and records of the company and of the exhibits of Mr. Watkins to which you have referred?

A. Yes, they do.

* * * * * * * *

[fol. 9937] Mr. Culton: And, on that assumption, do they reflect the amount of net income attributable to regulated sales and the amount attributable to non-regulated sales?

The Witness: Yes, as defined thereon, they do.

* * * * * * * *

Trial Examiner: I would like to ask Mr. Spacek if he heard the definition of Mr. Watkins for the words "pro forma".

The Witness: Yes, I heard that discussion.

Trial Examiner: You have used that phrase in connection with your Exhibit No. 51. Will you explain your definition of its use in connection with this exhibit?

The Witness: The words "pro forma", as used in Column (B) and, of course, as reflected in the other results shown in this exhibit, mean the consolidated revenues and expenses of the Panhandle Eastern Pipe Line Company and its subsidiaries, including the two subsidiaries that were acquired in 1942, for the full year 1941, after giving effect to operating costs which were actually effective for a part of the year but not for the entire year of 1941 as shown in Mr. Watkins' Exhibit No. 247.

The reason the words "pro forma" are used is that actually the Michigan Gas Transmission Corporation and the Indiana Gas Distribution Corporation were not subsidiaries of the Panhandle Eastern Pipe Line Company during the year 1941, and the "pro forma" is merely to [fol. 9938] indicate that those subsidiaries were combined,

together with the fact that the two other adjustments, namely, the taxes and the full year's costs, were also reflected in this amount.

Trial Examiner: Do you distinguish between consolidated analysis or an analysis of consolidated accounts for the purpose of the exhibit, and a pro forma exhibit or analysis?

The Witness: ~~Well, you see,~~ from an accounting point of view, the consolidation of Panhandle Eastern and the Michigan Gas Transmission Corporation and the Indiana Gas Distribution Corporation could not be consolidated as subsidiaries for the year 1941 because they were not subsidiaries during that period. Therefore, the pro forma indicates the effect as if they were subsidiaries for the whole year.

Trial Examiner: Does that mean it includes ~~and is~~ based upon the actual book records of the performance of those companies during the year 1941?

The Witness: It is based on the actual results of operations of those companies for the year 1941, adjusted only by the change there would be in the income taxes because the relationship of those subsidiaries to Panhandle Eastern, as compared to the relationship of those subsidiaries to Columbia, would have changed the taxes, so the result is this statement reflects the results of operation as if they would have been subsidiaries for the entire year.

* * * * * * * *

[fol. 9939] Cross-Examination.

By Mr Littman:

Q. Mr. Spacek, is there anything in Exhibit No. 251 which represents the result of the exercise of your judgment?

A. In general, my work and the work that I supervised was primarily the clerical allocation of the amounts appearing in Column (B) and submitted by Mr. Watkins in Exhibits 248 and 249.

Q. In other words, there is nothing in this exhibit which represents the result of the exercise of your judgment?

A. No. I would say, as a general matter, no. In other words, let me state this, that in the case of taxes and certain

items it was necessary for me to determine that the clerical work in allocation was performed on a basis consistent with the amount in the first instance. For example, take taxes on gas production which had to be allocated on the basis of production expenses. That was not judgment but it was merely to see that the calculation was applied properly in arriving at the amount assigned to regulated sales and non-regulated sales.

Q. You just pointed out that you did not exercise judgment in that respect.

A. I would say, if I understand your question right, I did not exercise any judgment in these calculations.

Q. Do you know what Mr. Biddison's theories of alloca- [fol. 9940] tion are?

A. I am generally familiar with them but I am not in a position nor am I taking any responsibility for those theories.

Q. Nor do you subscribe to them?

A. I neither approve nor disapprove of them.

Q. Now, let's examine page 1 of Exhibit 251 for a moment, Mr. Spacek.

A. Yes, sir.

Q. I call your attention to the M. c. f. gas sales volume figures which appear in lines 2, 3, 4, as among residential, commercial, and industrial. Where did you secure those M. c. f. gas sales volume figures?

A. I secured those gas sales volume figures from the books and records after Mr. Biddison informed me which customers were regulated sales and which were non-regulated sales.

Q. Do your working papers show your instructions from Mr. Biddison in that regard?

A. Well, they merely state what sales to which companies are to be regarded as non-regulated sales.

Trial Examiner: Might it not expedite matters, Mr. Littman, since the witness says he has in his possession the written instructions under which he worked, to let them be produced at this time?

Mr. Littman: I think that is a good suggestion.

* * * * * * * *

[fol. 9941] Mr. Culton: It is rather lengthy, but we will be glad to have it read into the record.

Trial Examiner: I think, in view of the testimony to date, that should go into the record.

* * * * * * * *

Mr. Littman: Mr. Examiner, during the recess I have had an opportunity to examine the letter to which the witness has referred, addressed by Mr. P. McDonald Biddison, consulting engineer, to Panhandle Eastern Pipe Line Company, dated April 8, 1942. I believe it would be well to have that letter copied into the record at this point as was originally suggested.

Trial Examiner: If you will furnish a copy to the reporter, it will be copied in at this point.

(The letter referred to is here copied into the record as follows:)

[fol. 9942] Dallas, Texas,

April 8, 1942

Panhandle Eastern Pipe Line Company,
Kansas City, Missouri.

Dear Sirs:

This will confirm my conclusions as to the proper basis of allocating the combined operating revenue and expenses of Panhandle Eastern Pipe Line Company and Subsidiaries (including Michigan Gas Transmission Corporation and Indiana Gas Distributing Corporation) between regulated sales and non-regulated sales.

Of the total sales of the four companies all direct sales to the following are those determined to be non-regulated.

Panhandle Eastern Pipe Line Company

Industrial Sales:

Kansas—

Osawatomie State Hospital

Phillips Petroleum Co.

Missouri—

Edwards Conley Brick & Tile Co.

Fayette Brick & Tile Co.

John Freiling

Harbison Walker Refractories

Mexico Refractories Co.

Phillips Petroleum Co.

[fol. 9943] The W. J. Small Co., Inc.

United Brick & Tile Co.

Universal Atlas Cement Co.

Walsh Refractories Co.

Wellsville Fire Brick Co.

United Brick & Tile Co. (Local area-Vale)

Field Sales (Kansas)

Gas Utilities (For power plant use)

Missouri Power and Light Co.

Illinois Natural Gas Company

Industrial Sales:

Black White Lime Company

Marblehead Lime Company

Menke Stone & Lime Co.

Indiana Gas Distribution

Anchor-Hocking Co.

Gasoline sales for this purpose are allocable between regulated and unregulated sales on the basis of M.C.F. sales.

Operation and maintenance should be allocated as follows:

227—12,466

All natural gas production expenses including gas purchased and gasoline production expenses are to be allocated on the basis of M.C.F. sales.

Transmission expenses—

Supervision and engineering should be allocated on the basis of the composite result of all other transmission op- [fol. 9944] erating expenses.

Pumping station labor should be considered 50% directly applicable to unregulated sales and 50% applicable to regulated and unregulated sales on basis of M.C.F. sold.

Pumping station supplies and expenses, and maintenance allocable on M.C.F. sales.

Pumping station structure maintenance as well as other transmission structure maintenance are demand costs of regulated sales only.

Measuring station labor, supplies, and expenses, and maintenance should be allocated to non-regulated sales to the extent applicable to facilities exclusively used for such sales and the entire balance represents demand costs of regulated sales.

Transmission main labor, supplies and expenses and maintenance are allocable to non-regulated sales to the extent applicable to laterals used exclusively for such sales and the entire balance of such costs represents demand costs of regulated sales.

Rents, other maintenance and other credits should be allocated on an M.C.F. basis.

Distribution expenses are all attributable to sales classified as regulated.

Customers' accounting and collecting expenses should be allocated on an M.C.F. basis.

[fol. 9945] Sales promotion expenses are applicable 50% to regulated sales and 50% to non-regulated sales.

Administrative and general expenses should be allocated on the basis of the composite results of all other operation and maintenance expenses as above.

Depreciation (including amortization) should all be allocated as a demand cost of regulated sales except the amount applicable to regulator and measuring stations and lateral pipe lines used exclusively for non-regulated sales which should all be assigned to non-regulated sales and depreciation on gasoline plant which should be allocated on an M.C.F. basis.

Amortization and depletion of producing natural gas land and land rights and abandoned leases to be allocated on M.C.F. basis.

Amortization of contracts, acquired and purchased, are all applicable to regulated sales.

Taxes—

Al valorem taxes should be allocated to regulated sales except such taxes reasonably applicable to stations and laterals used exclusively for non-regulated sales and to gasoline plant which should be assigned to non-regulated sales and allocated on an M.C.F. basis respectively.

Gross production, receipts and other taxes on a basis consistent with the method of assessment.

State franchise and capital stock taxes should be allo-
[fol. 9946] cated entirely to regulated sales.

Payroll taxes should be allocated on payroll or on the same basis of administrative expenses.

Federal capital stock and state and federal income and excess profits taxes on basis of net operating revenues.

Yours very truly,

(sgd.) P. McDONALD BIDDISON.

By Mr. Littman:

Q. Mr. Spacek, calling your attention again to the first page of Exhibit No. 251, Column (B), am I correct in understanding that the figures shown in that column, from lines 12 to 46, inclusive, were taken by you from Mr. Watkins' exhibits heretofore presented in this proceeding?

A. They were taken from those exhibits. They may show more breakdown or less breakdown, depending on

the requirements for regulating sales, but the bases of them are from Mr. Watkins' exhibits.

Q. In other words, the source of these figures from line 12 through 46 on page 1 of Exhibit No. 251 is Mr. Watkins' exhibits?

A. That is true.

Q. Mr. Spacek, it follows, does it not, that you are not expressing any opinion with respect to any of the figures shown in Exhibit No. 251 as to the propriety of [fol. 9947] their inclusion in this proceeding for rate-making purposes?

A. No, I am not expressing an opinion either way from the opinion expressed by Mr. Watkins and am taking no responsibility for it. I mean by that I am not saying that they are in any way erroneous. I accept them as they are without verification.

Q. And you have made no study, for purposes of this proceeding, with respect to the propriety of the inclusion of certain operating expenses and costs for purposes of rate making?

A. For purposes of rate making, that is true.

Q. Now, with respect to the letter that Mr. Biddison wrote to Panhandle Eastern, which letter was just copied into the record, did you follow Mr. Biddison's instructions throughout as they appear in that letter? A. Yes, sir.

Trial Examiner: Mr. Littman, I wonder if it would be of any use to us all if Mr. Culton or Mr. Wheat should give us some statement concerning the allocation that clearly appears in this Exhibit No. 251 and its bearing upon the issues in our proceeding?

Mr. Culton: Mr. Examiner, frankly this evidence bears very substantially upon these proceedings, and it was prepared in light of the opinion of the Commission in the Colorado case. Mr. Biddison tomorrow will be in posi- [fol. 9948] tion to testify as to his judgment of allocations between receipts from gas subject to regulation, that is, income from gas subject to regulation and gas not subject to regulation.

We had Mr. Biddison present his views of allocation and his conclusions as to the basis of allocation to Mr. Spacek and then had Mr. Spacek apply those views to the com-

pany's records and to the exhibits which heretofore have been offered in evidence, and tomorrow morning Mr. Biddison will testify with respect to the various matters contained in Column (C) of this exhibit, that is, as to the propriety of the allocation and the basis of allocation.

Mr. Littman: Mr. Culton, may I interrupt to inquire whether you are saying that Mr. Biddison is not going to testify with respect to any allocation among the regulated customers?

Mr. Culton: You mean among our customers—that is correct. The allocation to which he will testify will only be as between regulated sales and non-regulated sales.

Mr. Littman: As reflected in Exhibit No. 251?

Mr. Culton: That is right, just the basis for apportioning between regulated and non-regulated. He will not attempt to testify anything at all about apportionment as between various cities.

Mr. Littman: And he will also testify, I take it, with respect to what sales are, in his opinion, regulated and [fol. 9949] non-regulated?

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Mr. Littman: Thank you.

Trial Examiner: From your statement and your reference to what you have called the "Colorado case"—

Mr. Culton: (Interposing) That is Opinion No. 73.

Trial Examiner: (Continuing)—and which, I assume to be an opinion of the Federal Power Commission?

Mr. Culton: In Docket G-124, G-118, and G-121.

Trial Examiner: You are evidently forming some theory of law which has induced you to present Exhibit No. 251, attempting an allocation thereby and proposing the testimony of Mr. Biddison in further support of some allocation of, I assume, facilities and expenses?

Mr. Culton: Probably a better way to express it, Mr. Examiner, would be to say that we recognize that the Commission, in Opinion No. 73, has recognized the distinc-

tion between income obtained from gas, the price of which is subject to regulation, and income obtained from gas, the price of which is not subject to regulation. We think they have properly recognized and attempted to apply that distinction.

Now, the facts of this case are somewhat different from the facts of that case. Whether or not the same method of allocation should be applied is doubtful because of the difference in facts, but we do expect to present, through [fol. 9950] Mr. Biddison, the judgment of an engineer of experience with respect to what he thinks the basis for allocation should be and what elements should be considered. He will discuss all of these various items which are reflected in Exhibit No. 251.

Trial Examiner: I have a copy of Opinion No. 73 of the Commission before me and I wish you would point out both parts of this opinion which you are endeavoring now to apply in this proceeding.

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Trial Examiner: (Interposing) Will you give us a statement of your application of this opinion to the present case?

Mr. Culton: Frankly, Mr. Examiner, I am going to be frank with the Examiner, and, in saying this, I do not wish to cast any reflection on the author of the opinion in Opin. No. 73. We do not know what formula was applied in that case. Frankly, we are groping in attempting to construe that opinion. The author of that opinion clearly recognizes the necessity of making an allocation between these types of gas.

All of the facts existent in that case do not appear from that opinion and, as happens so many times, a person writing an opinion will have things in his own mind which [fol. 9951] are very clear to him but which will not be clear to someone who is not thoroughly familiar with all the facts. Therefore, we expect to suggest a suggested method of allocation between the two types of commodities as to which the Commission properly recognizes a substantial difference.

Trial Examiner: Can you give us some fairly brief general statement of how that allocation would work out according to your theory and interpretation of Opinion 73 and as demonstrated by proposed Exhibit No. 251?

Mr. Culton: Mr. Biddison will do that at considerable length, Mr. Examiner.

Trial Examiner: You are thinking of the figures from Exhibit No. 251 and I am thinking of the legal aspects.

Mr. Culton: There are some differences between the Colorado case and our case which we think should be recognized. One is that in the Colorado case, the deliveries were all in an area which had similar temperature. In our case, we do not have, in our markets, an area of similar temperatures. It will be cold on one section of the line, hot on the other, and sometimes it will be hot on that section and cold on the other. It, therefore, makes it necessary for us to have capacities able to serve the entire area irrespective of whether we have a cold day all the way through or not.

Another situation is that we have a varying type of industries served by our line, whereas most of the non-regulated gas served by the Colorado line went to one [fol. 9952] industry, a considerable portion of it. Mr. Biddison expects to discuss those various matters and give his views as an engineer as to why he thinks the classification which he has made in the letter which was delivered to Mr. Spacek and which classifications are reflected in Exhibit No. 251 are fair and reasonable classifications, and if those are fair and reasonable classifications, then the operating revenues, as reflected in Mr. Watkins' Exhibits 248 and 249, would be apportioned as shown on page 1 of Mr. Spacek's exhibit.

Mr. Biddison desires to make a further calculation tonight as to one phase of this matter which has occurred to him after having read the opinion in Opinion No. 73 in much greater detail and several times. He will not be ready to fully explain his view on that until tomorrow morning and until after he has made that computation.

We frankly recognize that this Commission is now faced with problems not heretofore faced by other regulatory

bodies, at least in the detail which the Commission now faces. It has a very long pipe line here. It has a portion of gas the price of which is subject to regulation and a portion of which is not subject to regulation. The industries are located at numerous points along that line several hundred miles long and there are towns along that line. It may be necessary, before this matter is finally determined, to go into the question of allocation between towns. [fol. 9953] Panhandle Eastern Pipe Line Company does not propose to present any views in that respect, feeling that is a matter as between its customers. It is not material to Panhandle Eastern what that allocation should be as between its own customers. It does think it is of importance, as the Commission has recognized, for an allocation to be presented so that the Commission can determine as best possible how much the expense of serving the regulated gas is and how much the expense of serving unregulated gas is.

Trial Examiner: Mr. Culton, in your proposed Exhibit No. 251 at page 5 and line 24, there seems to be a total indicated of 94.23 percent as percentage of the regulated sales to total sales.

Mr. Culton: Yes, sir.

Trial Examiner: What significance does that percentage have in this proceeding?

Mr. Culton: That happens to be an over-all percentage, Mr. Examiner. There are some items that are practically 100 percent allocated to regulated sales. Most of the rest of them are apportioned on the basis of M.c.f. sales volume.

Trial Examiner: Just assuming that 95 percent, roughly, is subject to regulation, and 5 percent or a little more is not subject to regulation, what is the effect of that fact on the determination of rate base and revenues and the other issues in this proceeding?

[fol. 9954] Mr. Culton: I do not understand that the Commission used those allocations in determining rate base, Mr. Examiner. As I understand it, they took the rate base—and this is as I understand their opinion and it is reasonable to me—they took the rate base and then determined cost of service.

These items which we have are all representing cost of service. That item to which Your Honor called attention happened to be the tax question and showed the percentage of the taxes which represented a part of the service of the regulated gas. There are other divisions with respect to all of these other types of expenditures, including the expense of amortization and depreciation. Some of those various items on an M.c.f. volume basis. Some of them are on the basis of all being charged to regulated sales and some items are all charged to non-regulated sales.

Have I sufficiently discussed the general aspects of the thing, Mr. Examiner?

Trial Examiner: Frankly, the Trial Examiner is anxious to have developed on this record your theory of the effect of the Commission's action as evidenced by its Opinion 73 insofar as it affects the issues in this proceeding, and I think it would be well to have as concise and coherent a statement as possible and as early as possible because we are approaching the conclusion of this proceeding. These things are, of course, for full development in the briefs, but before we close the record, we should [fol. 9955] know your conception of the issues and Mr. Littman's conception of the issues as affected by the Commission's recent action.

Mr. Culton: We consider Opinion 73 as reflecting the Commission's view, which we think is correct, that this company is engaged in a business of selling gas; that part of that gas is to be sold at a regulated price and part at a price which is not regulated; that the Commission has jurisdiction to fix the price of the regulated gas but no jurisdiction to fix the price of the non-regulated gas, and that if the price of the regulated gas is to be fixed by consideration of the profits earned by the company, then the price can be fixed as to the regulated gas only by considering the portion of those profits which were actually earned by the regulated gas.

We consider that the Commission has properly construed the Natural Gas Act and its functions in that respect and we recognize that there must be some kind of an allocation and we wish to be of any service we may in determining what would be a reasonable allocation.

Trial Examiner: Do you have other exhibits that deal with an allocation in addition to your exhibit marked for identification Exhibit No. 251?

Mr. Culton: We do not, Mr. Examiner.

Trial Examiner: So that consideration of this aspect of [fol. 9956] the case will revolve around Exhibit No. 251?

Mr. Culton: That is right. This is a suggestion which we have offered. Mr. Biddison, of course, will testify with respect to this exhibit and present his views as an engineer.

Mr. Littman: Is it your idea, Mr. Culton, that Exhibit No. 251 is in accordance with the Commission's opinion in the Canadian River case?

Mr. Culton: I did not say that.

Mr. Littman: I wondered if you thought that?

Mr. Culton: I have never seen their exhibit in that case.

Trial Examiner: I think you misunderstood the question, Mr. Culton.

Will you read the question back?

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Mr. Culton: I do not know what the question means, but my answer is, Yes, we are presenting what we consider to be a fair method of allocation. I do not say it is the same method of allocation which was presented in that case.

Trial Examiner: This is your theory of the application of the Commission's action to the facts of this case?

Mr. Culton: That is right, of the principles of the Commission's action.

Trial Examiner: Yes.

Mr. Culton: That is right. The Commission recognized [fol. 9957] that you cannot just put up a single standard and go by it because they applied one method of allocation as to one of the companies involved there, and a different method of allocation as to the other company involved, which shows it is a matter of judgment as to how you shall make your allocation, and we are making our suggestion as to what that allocation should be.

Trial Examiner: Is the Commission in this case, then, according to your theory, facing a matter of judgment as relating to or involving the unregulated sales to a large number of customers, whereas, in the Colorado case, it had just a few customers?

Mr. Culton: That is a distinction. Whether or not it is of itself enough to require the use of a different rule, I do not know and, as I stated a while ago, we do not know what their rule was in that case.

We are sorry that we cannot determine from the opinion exactly how they reached the conclusion that they did reach. The only thing we can do is to take the philosophy which they present and attempt to apply that philosophy the best we can to the facts of this case.

Trial Examiner: And you are applying it by individual treatment as regards the individual unregulated customers?

Mr. Culton: Not separated, Mr. Examiner; we have used the individual customers only for the purpose of determining how much gas was purchased by the cus- [fol. 9958] tomers whose rates are not regulated, and how much gas was purchased in the aggregate by those who are regulated.

We have not attempted to divide the cost of furnishing that gas up between the various customers whose rates are not regulated. We have made a division purely between the regulated business and the unregulated business.

Trial Examiner: Isn't your result, frankly, an arbitrary result?

Mr. Culton: As any method of allocation will be, that is true. It is a matter in that there is no absolute standard by which you can be guided. It is purely a matter of judgment in making your allocation, and whether or not it is the correct allocation depends on whether or not your judgment has been properly exercised. It may be properly exercised as to most of the items and not correctly exercised as to some others. Of course, that is a matter this Commission will take notice of and that is the reason why we have set all of these various items out in the way we have so that the Examiner and the Commission can be

advised of just exactly how we have arrived at this conclusion.

Trial Examiner: We won't ask Mr. Littman this afternoon to express his views of the application of the Commission's recent action to this proceeding but we would appreciate a statement tomorrow, after time is given to consider the proposed Exhibit 251 and the reference to [fol. 9959] those sections of the opinion which Mr. Culton has mentioned.

* * * * * * * * * *

Trial Examiner: It is evident that Exhibit No. 251 is one of the most important that has been introduced and it should receive very careful consideration before we recess and before Mr. Spacek is excused, and I think that should be accompanied by a statement from Mr. Littman as to his view at this time as to its relevancy and meaning [fol. 9960] or importance in this proceeding.

By Mr. Littman:

Q. Mr. Spacek, you have already testified you did not exercise your judgment in compiling this exhibit, did you not? A. That is right.

Q. I take it you have no opinion as to the use to which this exhibit should be put in this proceeding?

A. You mean I am not expressing an opinion to the Commission as to how the results should be used?

Q. Yes. A. No, I am not expressing an opinion.

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Redirect Examination.

By Mr. Culton:

Q. Mr. Spacek, your company does audit the accounts of Panhandle Eastern every year, does it not?

A. Of Panhandle Eastern?

Q. Of Panhandle Eastern. A. Yes, sir.

Q. And some of the members of your staff who do the actual auditing participated in this work? A. Yes, sir.

Q. Under your instructions? A. Yes, they did.

[fol. 9961] Q. And by saying that you took no responsibility, you merely meant insofar as the basis of allocation is concerned?

A. Yes, as to the basis of allocation and also as to presenting these amounts appearing in Column (B) for rate purposes. We have audited them for annual report purposes but we have not made an examination for the purpose of presentation in a rate proceeding.

Q. And by that you mean you are accepting no philosophy from a rate standpoint? A. That is true.

Q. For example, in residential sales, 78,213 is in accordance with the company's books, the very first item of M.c.f. sales volume?

A. Yes, the gas sales volume, of course, is just a summary of the statistical information shown in the company's books which we examined.

Q. That is right, and the various items shown in Column (B) are reflected in the company's books for the specific items shown in Column (A)?

A. They are shown in the company's books. They are taken directly from the company's books except those items—

Q. (Interposing) The "as-if" items?

A. The "as-if" items as pertaining to the taxes and the operating costs which are not effective for a full year.

[fol. 9962] Q. And those "as-if" items are fully described on page 6, or referred to, at least?

A. That refers to Mr. Watkins' exhibits, which in turn, show the adjustments which he made to the amounts shown by the books.

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[fol. 9963] By Mr. Goodman:

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[fol. 9964] Q. No; if there were no regulated sales, would it then follow that the non-regulated sales could be made or handled at a production cost of 13.2 percent of the total which is the amount allocated to production for non-regulated sales?

A. I cannot say what the conditions would be other than what actually happened here.

Q. Is there anything in this exhibit to indicate that fact or that conclusion?

A. Only insofar as Mr. Biddison might say that that would be a fact because he gave the basis of allocation.

Now, if the philosophy of his basis of allocation is such that Mr. Biddison could answer the question that you asked, that is the only method by which I could answer it.

Q. I see. Then, I will put it this way: So far as you know, there is nothing in this exhibit purporting to have the effect that the non-regulated sales, standing alone, could be made subject to a production cost of 13.2 percent of the total indicated production cost. Is that right?

A. I do not think the exhibit shows that, but I cannot answer your question.

Q. You cannot answer?

A. No, I cannot answer that question.

Q. All right, let's go on to another.

[fol. 9965] A. I would like to amplify on that and say I cannot answer the question because this exhibit is built upon conditions that actually did exist, not on what did not exist.

Q. In other words, the hypothetical production costs for the non-regulated sales, without the existence of regulated sales, might be an entirely different figure, isn't that so? A. I presume it might.

Q. Yes.

A. Mind you, that is just a guess, as far as I am concerned. I have no means of saying it will be or will not be.

Q. Let's turn to page 3 of the same exhibit and referring to Account No. 758, supervision and Engineering, are you able to say, from your investigation of the data before you, that if the non-regulated sales did not exist, $10,414.34 would be saved?

A. I cannot answer that question either.

Q. I see. Now, let's take it the other way. Would you be able to say, from your investigation of the books and records such as you have made in connection with this exhibit, that if the regulated sales did not exist, supervision and engineering could be had for the non-regulated sales at a cost of $10,414.34?

A. I am not able to answer that either.

Q. All right. Now, would your answer be of the same [fol. 9966] tenor to any other item of the same general nature in the exhibit?

A. Just looking the exhibit over, I do not believe I could state that there is any one item that exists under

conditions different from those under which they actually existed. I have no way to say that any item of expense would or would not exist. I do have reason to believe that these items were incurred in the normal course of business as we examined the books, subject, of course, to my previous comments.

Q. Well, now, we have an item here, pumping station structures, 100 percent of which is assigned to regulated sales. Now, I take it that means that that item would not be incurred, that is, that maintenance item would not be incurred, if the business were exclusively confined to the non-regulated sales such as exist, is that right?

A. You are asking me a question which directly should be directed to Mr. Biddison. I could not answer that either. That goes into the basis of allocation about which I am not in a position to answer.

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[fol. 9977] P. McDonald Biddison a witness, having been previously sworn, resumed the stand and testified further as follows:

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[fol. 9978] Redirect Examination

By Mr. Culton:

Q. Mr. Biddison, are you familiar with the Opinion No. 73 of the Federal Power Commission issued in Dockets No. G-124, No. G-118 and No. G-121?

A. I am familiar with it to the extent that I have read it and studied it.

Q. After having read and studied that opinion, did you attempt to determine a reasonable method for allocating costs of Panhandle Eastern Pipe Line Company and its subsidiary companies, including Michigan Gas Transmission Corporation, between regulated and non-regulated sales? A. Yes, sir.

Q. After having made that study, did you furnish to Mr. Spacek a letter dated April 8, 1942, with respect to the [fol. 9979] various classifications of sales and expenses?

A. I did.

Q. Were you present yesterday when a purported letter from you to Mr. Spacek was offered in evidence which now appears on page 9942 of the transcript? A. I was.

Q. Is that the letter? (indicating)

A. That is the letter. I have not read the letter as it is typed in the transcript, but that is the letter.

Q. In your opinion, does the classification of sales therein set out between regulated and non-regulated sales present a fair classification of such sales? A. Yes, sir.

Q. Does the classification of expenses set out therein, in your opinion, represent a fair classification between those classes of expenses of regulated sales and non-regulated sales? A. Yes, sir.

Q. What was the fundamental basis of your allocation of costs in your instructions to Mr. Spacek?

A. The fundamental basis was first, that direct sales, that is, sales not for resale were non-regulated business and that sales for resale were regulated business; that to each class of business there should be assigned those costs which were caused by the respective classes in the proportions caused by the respective classes; that the direct industrial sales of this company, that is, of Panhandle East-
[fol. 9980] ern Pipe Line Company and its subsidiaries, do not contribute to the requirement of the provision for capacity upon peak days.

That is the fundamental basis.

Q. Did the letter given by you to Mr. Spacek incorporate that basis throughout.

A. Yes, sir, it was based upon that basis.

Q. Have you now examined Exhibit No. 251 which has been offered in this case by Mr. Spacek? A. I have.

Q. Do the allocations therein contained comply with the basis which you have just given as your judgment for the proper allocation? A. They do.

Q. In your opinion, are the allocations therein provided reasonable between gas subject to resale or gas sold for resale and gas not sold for resale? A. Yes, sir.

Q. Is there any other cost connected with the production and transportation of gas which is not included among those costs which are reflected in Exhibit No. 251?

A. Yes. If we consider the return obtained, whatever that return may be, the fair return to be a cost of the service, that item of fair return must also be allocated in

addition to the items which have been allocated in Exhibit No. 251.

[fol. 9981] Q. Have you made a study of Panhandle Eastern's situation for the purpose of reaching a conclusion as to a reasonable method for allocating the return between the regulated gas and the non-regulated gas?

A. I have.

Q. What, in your judgment, would be a reasonable method for such allocation?

A. Following the same basis as outlined for allocation of costs as I have already stated that basis, the return which is based upon property should be allocated to the two classes of business in the proportions that the respective classes of business cause investment in property.

Q. Have you applied that rule in an attempt to arrive at a reasonable allocation of Panhandle Eastern's properties? A. I have.

Q. Will you explain what the result of your study in that respect has been?

A. The consolidated property account of Panhandle Eastern Pipe Line Company, as of February 28, 1942—

Q. (Interposing) Do you happen to have the exhibit number?

A. Yes, sir, from Exhibit No. 197 by Mr. Watkins.

(Continuing) is, in round numbers, $84,998,335. Included in that amount are production land and leaseholds, gas wells, production system structures, drilling and clean-out equipment and other production system equipment in the amount of $4,519,177 and gasoline and dehydration [fol. 9982] plant in the amount of $704,284. These two items total $5,223,461. They constitute 6.15 per cent of the consolidated plant account of $84,998,335.

The balance of the plant account is, then, in round numbers, $79,774,894. Of that amount, there is property consisting of lateral lines and their measuring and regulating stations in the amounts of $95,981 and $32,866, respectively, used exclusively in connection with direct sales. The sum of these two items is $128,848. This sum is 0.1625 per cent of the balance of $79,774,894. This constitutes the property, outside of production property and gasoline prop-

erty, required to be provided for the sale of the direct sales by Panhandle Eastern and its subsidiaries.

From Exhibit No. 251, Column D, line 10, 86.8 per cent of the volume of sales are sales to the regulated business. Therefore, of the return on this production property, 6.15 per cent of the total 86.8 per cent should be allocated to the regulated business. The product of these two figures results in an allocation on this account of 5.34 per cent of the return to the regulated business.

Mr. Littman: You mean the unregulated business, don't you?

Mr. Lee: 5.34, that is unregulated?

The Witness: I mean just what I said.

Mr. Culton: Will you explain it over again, please? Counsel think you probably used the wrong word.

[fol. 9983] Trial Examiner: Will you read back the answer, please?

(Whereupon, the last answer was read by the reporter.)

The Witness: That is right. When I have completed my allocation, I think the matter will be explained.

Mr. Culton: All right.

Q. Continue with your explanation and they can ask questions if they are not clear.

A. Now, I have allocated that portion of the return which is allocable to production and gasoline property. If we deduct the 6.15 per cent which is the production and gasoline property from 100 per cent, we have left 93.85 per cent of the return still to be allocated. This amount is to be allocated with reference to the $79,774,894. Of that amount, .1625 per cent is required by and devoted to non-regulated business so, dropping the fraction, 99.84 per cent is required by and devoted to the regulated business; so 99.84 per cent of 93.85 per cent of the total return or 93.70 per cent of the total return is allocable on this account to the regulated business.

The sum of the two allocations, that is, the sum of 5.34 per cent and of 93.70 per cent is 99.04 per cent of the return to be allocated to regulated business.

Q. Then what would be your final figures to apply to the regulated business and the final figures to apply to the [fol. 9984] unregulated business?

A. To allocate to the regulated business 99.04 per cent of the return and to the unregulated business, 0.96 per cent of the return.

Q. And to what return would those percentages be applied?

A. To whatever is, in final analysis, found to be the fair rate of return for this company applied to what is found to be the fair rate base. In other words, it is the total amount of the fair return.

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[fol. 9988] By Mr. Goodman:

Q. All right.

Now, referring to the item of supervision and engineering, would you say that under the hypothesis which I mentioned—that is, if the non-regulated sales were discontinued, that any part of the $3,214.75 would be saved?

A. Yes, sir.

Q. Now, can you state or calculate what part?

A. No, sir.

Q. Is it possible to do so?

A. Why, I think an estimate could be made of it, yes.

Q. Could you indicate what supervision and engineering services could be dispensed with?

A. Not without going to the work of making the study. The amount would be pretty small.

Q. Do you think you could dispense with an employee who does supervision and engineering?

A. I don't know, without making investigation.

Q. That is, you wouldn't know that?

A. I said I didn't know without making an investigation.

Q. You are not familiar enough with the business to be able to say; is that right?

A. I am not familiar enough with the business to be able to say whether you could dispense with an employee. I [fol. 9989] am familiar enough with the business to know that you could make some reduction in that amount.

Q. Well, if you couldn't dispense with an employee, you would have to reduce somebody's pay, wouldn't you?

A. No. Certainly not.

Q. Now, in what way, then, would that saving come about?

A. You might perform some other duties that would be charged against some other account.

Q. That is the way that you would suggest?

A. I don't make any suggestion about it at all.

Q. You mean that through the saving in time you would be able to dispense with some other employee or reduce his pay? A. No. I don't mean that at all.

Q. You don't? A. No.

Q. Now, just try to give some indication as to the manner in which the saving you have in mind would be accomplished.

A. Well, if the amount of time devoted to supervision and engineering in that account were lessened by virtue of the fact that there were not quite so many duties to be performed, the people who did perform these duties to the extent of $3,214.75 might remain on the payroll and perform some other duties which would be charged to some other account.

[fol. 9990] Q. Yes, but the saving would only take place if some other employee's pay were reduced or his services dispensed with? A. No; not necessarily.

Q. You don't think so? A. No.

Q. Well, would you save anything in gas well labor?

A. Yes. You would save some in gas well labor.

Q. And how would that come about?

A. It would come about by virtue of the fact that there wouldn't be as much of it required and, therefore, there wouldn't be as much of it charged to the account.

Q. Well, what kind of labor would be dispensed with, Mr. Biddison?

A. Gas well labor. The labor required for attendance upon gas wells.

Q. You mean to say if the output of gas were reduced by about 13.2 percent, you could dispense with some gas well labor? A. Yes.

Q. How much?

A. I don't know. I haven't made any estimate of it.

Q. 13.2 percent of it?

A. I doubt if, but I haven't made an investigation of it.

Q. You doubt it? A. Yes.

[fol. 9991] Q. Well, how about fuel line labor? Would your answer be the same?

A. That is really field line labor. My answer is the same. No, my answer on that is that as to that field line labor, there probably would be no reduction by virtue of the elimination of direct industrial sales. I believe that item would remain the same.

Q. Now, field measuring and regulating station labor. How would you answer that?

A. That labor would be slightly reduced if the sales to the direct industries were eliminated.

Q. Other production labor?

A. I think that item would be somewhat reduced if the sales to direct industries were curtailed.

Q. Now, gas well supplies and expenses.

A. I think that item would be affected very little, if any, by curtailment of those sales.

Q. And fuel line supplies and expenses.

A. I think there would be no curtailment of that item on that account.

Q. Field measuring and regulating station supplies and expenses.

A. I think there would be no curtailment on that.

Q. Other supplies and expenses.

[fol. 9992] A. I think there would be a curtailment of that item.

Q. Delay rentals.

A. I think there would be a curtailment of that item, yes, sir.

Q. Gas well royalties.

A. There would be a very definite curtailment of that item in direct proportion, probably, to the reduction in M.c.f. produced.

Q. In other words, approximately 13.2 percent?

A. Yes.

Q. Is that right? A. That is right.

Q. Now, in maintenance, would there be any reduction?

A. Very little, if any.

Q. All right.

Q. Now, that brings us down to the item marked "Residual Operation Expenses"; isn't that right?

A. Yes, sir.
Q. All right.

Now, will you give me an idea of what they are: these residual operation expenses?

A. These are expenses of operating the gasoline and dehydration plant.
Q. And would there be any saving in that regard?
A. Yes, sir.
[fol. 9993] Q. Would you know how much? A. No.
Q. In connection with gas purchased, would there be a saving? A. Yes, sir.
Q. Could you say how much?
A. Well, it could be reduced in the proportion that the M.c.f. of sales was reduced.
Q. All right.

Now, you then have made no attempt to compute the amounts which would be saved or the avoidable costs, if the non-regulated sales were not made; is that right?

A. That is correct. I explained the basis on which I set that matter out.
Q. All right.

Now, passing on to transmission expense, would there be any saving in respect to the item of supervision and engineering if the non-regulated sales were not made?

A. I don't believe so, no.
Q. Now, pumping station labor: would there be any saving in that respect? A. Yes, sir.
Q. And could you indicate the amount in any way?
A. No. I haven't gone into that matter. I can't tell you the amount of it without investigation. I can tell you [fol. 9994] the trends on some of these items.
Q. All right.
Pumping station supplies and expenses, would there be any saving? A. Yes, sir.
Q. Would it be substantial?
A. Yes, it would be substantial.
Q. Now, looking at the items of maintenance shown on page 3 of the exhibit, would there be any saving in any of those items if the non-regulated sales were abandoned?
A. Yes.

Q. Will you point out the items?

A. Well, you have a saving in the maintenance of measuring and regulating station structures. You would have a saving in the maintenance of some of those mains that are used exclusively for that business—you wouldn't have them at all. You would have a reduction in the cost of maintenance for pumping station equipment. You wouldn't be pumping as much gas, therefore, you wouldn't have as much maintenance. You would have a reduction in the maintenance of measuring and regulating station equipment for the same reason that you would have it on structures.

Q. Now, referring again to page 2 of the exhibit. Will you assume that the regulated business were dispensed with? Could all non-regulated sales be made at the production expenses indicated in Column F of your exhibit? [fol. 9995] A. I don't know.

Q. Do you have any idea?

A. Not without some investigation on it, I don't.

Q. Do you think that if the regulated sales were eliminated that supervision and engineering for the plant could be had for $3,214.75? A. I just don't know.

Q. You don't know and you don't have any opinion; is that right?

A. That is right. I haven't made any investigation on it. I have no basis for an opinion on it.

Q. Well, take the item of $800.31 for gas well labor. If the regulated sales were eliminated, could the required production be accomplished on that amount of gas well labor?

A. Well, I don't know. If you eliminated the regulated business, you might run this non-regulated business on an entirely different basis. You might not have any production force. You might buy your gas for a business of that size. Any thing could happen. What would happen, I don't know, because I have made no investigation.

Q. Well, I am dealing with this particular business.

A. So am I.

Q. And I am attempting to develop the direct burden of each class by trying to observe what costs would be [fol. 9996] avoidable should a particular item of business be dispensed with.

A. Well, that method doesn't develop costs for classes of business.

Q. Well, we will argue about that later. I am just asking you for your conclusion as to certain facts. If you don't have the regulated business, Mr. Biddison, you indicate that your development of productive capacity would have taken a different course entirely; is that right?

A. No. I said it might have.

Q. It might have? A. Yes.

Q. Well, in all probability, you wouldn't have these extensive gas fields.

A. Well, there, as a matter of fact, whether you produce your gas or buy it; whether you sell regulated business or don't sell it; whether you sell non-regulated business or don't sell it; the fields are there.

Q. And would you drill the wells?

A. I don't know what you would do. I haven't made any study of what you would do if you didn't have any business or if you didn't have the big end of your business or if you didn't have the little end of your business.

Q. Well, now, it is a fact, is it not, that the costs of production of the non-regulated business are not in this [fol. 9997] business separately incurred?

A. That is right.

Q. Except possibly for royalties or a few items which vary with the units of production; is that right?

A. They are not separately incurred on any of those items—

Q. All right.

A. —for either class of business?

They are jointly incurred by the business as a whole.

Q. And it is reasonable to suppose, Mr. Biddison, that the joint product or the joint undertaking is a more economical venture than would be the undertakings separately considered? A. That is right.

Q. I think so. A. Yes.

Q. So that the regulated business contributes to economies in the regulated service? A. Yes, that is right.

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[fol. 9998] By Mr. Chamberlain:

Q. I would like to see, Mr. Biddison, whether I have understood your allocation correctly, and I would like to

see if I can place it in a different way than you have and still reach your result.

If I understand it correctly, you have eliminated the production system as your first move, and then allocated a portion of that to the non-regulated business in proportion to the amount of the unregulated sales to the total sales?

A. Well, no, I didn't specifically allocate the property on that at all, but 6.15 percent of the total property is in property used for production of gas and gasoline and I think, therefore, that 6.15 percent of the total return should be allocated between the two classes of business in the proportion that those two classes of business cause the expense of gas and gasoline production.

Q. You have apportioned that directly in the proportion of the sales, have you not? A. That is right.

Q. The volume of use? A. That is right.

Q. Now, did I understand you correctly that the lateral lines and the measuring stations which you deducted were those which were used in serving the non-regulated busi- [fol. 9999] ness? A. That is correct.

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By Mr. Chamberlain:

Q. Well, I have just had this, Mr. Biddison. It is a little difficult for me. I am merely trying to get at your ideas about this, and I would be glad to have you correct me anywhere in my questions here, but if I get at your position, you take the position that the return should be apportioned in such a way that the non-regulated business should contribute nothing for the use of the transmission system or for any of the property other than the production system plus these lateral lines that were built to serve [fol. 10000] that non-regulated business?

A. Are you speaking now of return only?

Q. Yes.

A. Since the non-regulated business does not contribute to the investment required to meet peak requirements, I have held that there should be allocated to the non-regulated business only that portion of return represented by the proportion which these lateral lines and individual meter stations represent in the total of that property exclusive

of production property on the main body of your transmission system.

In other words, the non-regulated business causes no investment. Therefore, on the bulk of that property, it should be allocated no portion of the return.

Q. Yes, I so understood that.

Now, let me approach it from this way. You have first segregated, let me say, 6.15 percent of the property—or, let us say, of the plant accounts? A. Yes, sir.

Q. That is right, isn't it? A. Yes, sir.

Q. Now, you have assumed that 86.8 percent of the sales were made for the regulated business, which would leave 13.2 per cent for the non-regulated?

A. That is right.

[fol. 10001] Q. Now, if one multiplies the 6.15 percent of the property by 13.2, he arrives at .811, does he not—.8118? A. .8118.

Q. That would be .8118, would it not? A. Yes, sir.

Q. Now, as far as we have gone, that is the proportion of that part of the return which you would allocate by reason of this production property?

A. Against non-regulated business?

Q. Yes. A. Yes, sir.

Q. Now, if I understand you correctly, you are to add to that the percentage which the property used exclusively for non-regulated business bears to the remaining portion of the plant account, or .1625 percent?

A. That is the ratio. I used .16 in working it out. Dropped a fraction.

Q. All right.

Now, by adding your .81 and your .16, you arrive at .97, which is substantially what your figures were for that portion of the return which you would allocate to the unregulated business; is that right?

A. No. No. Of this, what we will call the main line property, that is property exclusive of the production property that I have eliminated, about 16/100 of one per-[fol. 10002] cent is devoted to the non-regulated business.

Now, .16 percent then of the return not previously allocated is to be allocated to that business. Now we have

already allocated 6.15 per cent, so we have 93.85 percent to allocate, which will allocate .16 percent to the non-regulated business, so .16 times 93.85 gives—93.85 percent of—wait a minute—of the .16 percent is in round numbers, .15 percent, and that together with the .8118 percent gives you .9618 percent.

Q. Yes. Well, all right. I mistook the .16.

A. That balances out the other one.

Q. Yes, that is correct now. That balances. I was taking it of the lesser amount.

Now, then, the effect of that is that you would make a charge against the public on the regulated sales for all of the return except that upon the 13.2 percent of the production property and .15 percent for property used exclusively for delivering the non-regulated gas?

A. That is correct.

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Mr. Chamberlain: That should be 13.2 percent of the [fol. 10003] percentage, would it not?

The Witness: Yes. 13.2 percent of 6.15 percent.

By Mr. Chamberlain:

Q. Yes, that is right.

A. The 6.15 percent representing the proportion that production property is of the total properties.

Q. Now, I observe that you have allocated to the non-regulated sales a portion of the gasoline revenues. Will you give us your reasons for that allocation? That is in exhibit 251.

A. While it is true that the revenues from the sale of gasoline are not fixed by this Commission, yet during the conduct of this case, the gasoline business has been handled as if it were part of Panhandle's utility business. The expenses of that base are included in expenses, and the earnings from that business become, therefore, a credit to the cost of doing the strictly utility business.

In effect, then, the distribution of the operating costs in Exhibit 251 for gasoline production and of the reve-

nues is an allocation between the two classes of business of a little bit of net profit. That net profit being derived substantially in proportion to the volume of gas consumed by the two classes of business.

Q. In making your apportionments, you have taken the volume of sales or deliveries, have you not?

[fol. 10004] A. That is correct; yes, sir.

Q. And the gasoline extraction process is a process for —well, it is a processing of the natural gas, is it not?

A. Yes, sir.

Q. And it makes it easier delivery and also extracts the condensable hydrocarbons, does it not?

A. That is right.

Q. And they would otherwise make trouble in the line?

A. That is correct.

Q. It is then, in effect, a part of the natural gas business, is it not, and really a necessity, or, at least, an improvement in the art of transporting gas?

A. Well, it is an improvement in the art of transporting gas, without question. Whether it becomes a necessity is dependent upon the character of the gas, in the first instance, and how it is going to handled and where it is going to be marketed, in the second instance.

Q. Now, the allocation you have made of costs is one in which you have applied a very small amount of depreciation to the non-regulated sales. Will you give us your reasons for that?

A. Well, the reason is that depreciation, as an item of expense, is accrued against property. The property required to conduct this non-regulated business is a small [fol. 10005] percent of the main line property. Therefore, the amount of depreciation which is allocated against this non-regulated business is a small proportion of the total accrual for depreciation, being that proportion which the property devoted to the service bears to the total property for the two services.

Q. In other words, you have attempted to deduct and make as a charge against non-regulated sales, the depreciation only of that property which you hold was of service in the non-regulated business?

A. Which was required for the carrying out of that business, yes, sir.

Q. Now, you find, as shown by exhibit 51, that the revenues from the non-regulated sales amounted to $1,500,-527, do you not?

. . . .

Q. I refer, of course, to your allocation.

Trial Examiner: Do you mean 51 or 251?

Mr. Chamberlain: 251.

A. That is the result of the allocation of the total operating revenues.

[fol. 10006] By Mr. Chamberlain:

Q. Now, eliminate the expense for Federal income and excess profits tax and give me the amount of the entire operating revenue deductions which you have allocated against this class of business.

A. The total revenue deductions for that class of business, as shown at Line 42—no, Line 41— is $848,761.19.

The Federal income and excess profits taxes allocated to that business are $349,062.28. Cross out that entire answer.

Q. That would be correct. The subtraction there would give you the answer.

A. No. The answer is all right there so far. The amount of deductions exclusive of the Federal taxes is, therefore $499,698.91.

Q. Yes.

Now, what would be the net revenue for these non-regulated sales before provision for Federal income and excess profits tax? I can give that to you the same as Mr. Spacek did last night, if you wish, and you can correct it later, if you find it wrong.

A. Well, the total operating revenues for that business, as shown in Column F, at Line 23, is $1,500,527.89, and if we deduct the $499,698:19, which I have just derived for you, we have left about a million dollars, in round numbers.

[fol. 10007] Q. $1,000,882.98, is it not?

A. I make it $1,000,882.98. Does that check your figure?

Q. Yes, that is right.

Now, that is what you figured to be the net operating revenue or income on the non-regulated sales before provision for Federal income tax and excess profits tax, is it not?

A. Well, I didn't figure it, but that is the amount that results from the basis I set for the computation.

Q. Yes, and that you believe to include all of the costs which should be allocated to the non-regulated sales, does it not? A. No, it does not.

Q. Other than return and Federal income tax?

A. Yes, other than return and Federal tax, it does, yes.

Q. Yes. All right.

Now, have you made any computation to see what proportion of the return you would allocate to this non-regulated business?

A. Proportion?

Q. I mean, you have fixed it as .96 percent of the fair return, but let us go back to your first figures and assume a [fol. 10008] fair return. You started out in your computation with $84,998,335, did you not? A. Yes, sir.

Q. Let us assume now—take any figure near that that you want and set your return, let us say, 6.5 percent as was fixed in a recent case.

What would that return be by that amount and what amount would you allocate now to the non-regulated sales under your theory?

Trial Examiner: For convenience in figuring, I suggest ninety million base and 6 percent return.

Mr. Chamberlain: Yes. All right. Try that.

A. Well, ninety million base with a 6 percent return would give a total return of $5,400,000.

Q. Now, what portion of that would be allocated to 13.2 percent of the volume of sales which you would classify as non-regulated?

A. Well, to the non-regulated business, I would allocate .96 percent.

Q. Yes.

A. That is close to 1 percent or about $54,000, roughly.

Q. In other words, you would ask the public to pay for the regulated business all but $54,000 out of a five million

four hundred thousand return, and you would allocate to that part which has a net profit before income tax and [fol. 10009] before return of a million dollars?

A. I don't ask the public to pay for anything except pay their gas bills.

Q. Well, that is a result of your allocation, is it not, Mr. Biddison?

A. No. The result of the allocation is to allocate the return against the classes of business in the proportion that the classes of business have caused investment and have caused costs.

Q. Now, I would like to have the record show a couple of more details here.

Will you give me the amount received per M.c.f. for these non-regulated sales?

A. In Exhibit 251, Line 10, Column F, the sales shown to be 8,259,026 M.c.f., and the revenues from them are shown in the same column at Line 20, to be $1,403,497.60, and from that I derive that the average revenue per M.c.f. is approximately 18.2 cents.

Q. Are you including Line 20 there or 23? My figures would indicate it is 18.2 for the million and a half.

A. Which figure did I read off there?

Q. You read the million four hundred three.

A. The revenue from gas sales shown at Column F, Line 20, this being gas sales only, is $1,403,497.60, and the [fol. 10010] revenues per M.c.f. from that figure—that is, gas only—is about 17¼ cents.

Q. 17.24? A. About 17¼ cents.

Q. About 17¼ cents? A. Yes.

Q. Now, include in that, then, the revenue which you have allocated to the non-regulated sales arising from the gasoline revenues and see what the total revenue per M.c.f. is.

A. Well, that total revenue, including a little bit of miscellaneous—however, none of that miscellaneous is allocated against the non-regulated business—that total revenue amounts to $1,500,527.89, and revenues per M.c.f. of sales from that total amount is about 18.3, I guess, cents.

Q. Now, what are the expenses other than Federal income and excess profits taxes per M.c.f.?

In other words, to apply your—

A. (Interposing) The expenses other than the Federal income tax?

Q. Yes. A. Per M.c.f. of sales?

Q. Yes.

A. Well, the expenses exclusive of those items are $499,698.91, substantially a half million dollars, and on [fol. 10011] 8,259,026 M.c.f., that amounts to approximately 6.07 cents per M.c.f., as near as I can read it on the small slide rule.

Q. Substantially 6.1, is it not? A. Yes.

Q. Now, if you were to deduct the costs that you have allocated, other than the Federal income and excess profits tax, you would have a net income from the sale of the non-regulated gas of 12.1 cents per M.c.f., would you not?

A. Well, I have been running some calculations through here without keeping a memorandum on them, but my recollection was that we had, including gasoline sales, about—

Q. (Interposing) 18.2?

A. (Continuing) —18.2 cents per M.c.f., and this last calculation of expenses, exclusive of Federal tax, was about 6.1. That leaves a spread of about 12.1.

Q. Now, take the net operating revenue, as shown in Line 42 of your Exhibit 251, and give us the amount per M.c.f., that you find that to be.

A. Well, the amount is $848,761.19.

Q. I am sorry, but I intended to ask you about Line 42, the net operating revenue which I believe would be $651,766, would it not?

A. Yes. That is my error. I am on the wrong line. The net operating revenue. $651,766.70, which, on 8,259,026 M.c.f., is approximately 7.9 cents.

[fol. 10012] Q. Now deducting from the 18.2 cents which—

A. (Interposing) No. Wait a minute. Wait just a minute.

Q. That checks with our figures, doesn't it?

A. That is right.

Q. Deducting that amount from the 18.2 cents which was the revenue per M.c.f., you would have a net operating revenue of 10.3 cents per M.c.f., would you not?

A. That is right.

Q. Now, I would like to compare that with the revenues for the regulated sales.

Will you give me the same figures with respect to those?

A. Well, on the regulated sales, we have a quantity as found in Column E, at Line 10, of 54,302,700 M.c.f., and operating revenues, including gasoline, as shown in Column E, at Line 23, of $16,289,045.01. That is a revenue of approximately 30 cents.

Q. Per M.c.f.? A. Per M.c.f.

Q. Now, what are the revenue deductions without Federal income and excess profits taxes per M.c.f.

A. The total revenue deductions, as shown at Line 41 are $10,634,992.97, of which $3,209,166.84 are Federal income deductions. So the deductions, exclusive of that, amount to $7,425,826.13, and that, on 54,302,700 M.c.f., [fol. 10013] amounts to about 13.65 cents.

Q. I have 13.7 here.

A. Well, that might be it. I am working with a five-inch slide rule and trying to read it in three places.

* * * * * * * * * *

Q. Then the net revenue, before deduction for income tax and excess profits, would be the difference between 30 cents and 13.7, would it not? A. Yes.

Q. Or 16.3?. A. That is right.

Q. Now, give me the amount of the net operating income per M.c.f. of the regulated sales, as you have found them in your Exhibit 251.

A. Well, that net figure is $5,654,052.04. And, on 54,302,700 M.c.f., that is approximately 10.4 cents.

Q. Now, if I understand your Exhibit 251 correctly, the allocation which you have made is one by which the company would make from its regulated sales as net operating revenue, after income tax, of 10.4 cents, and from their non-regulated sales, 7.9 cents?

A. I don't know. I haven't a record of those figures. [fol. 10014] Q. Those are just as you gave them to me, Mr. Biddison. A. I believe 7.9 was right.

Q. Yes, sir.

We can always correct these, if you don't find them right.

A. Yes, sir.

Q. And notwithstanding the profit is so nearly the same, you figure that the allocation of the rate of return which is the only element of the cost which you say is now left out, should be the proportion of .96 percent of the return allocable to the non-regulated sales?

A. That is right, and if you were to take these spreads that we have just worked out and weigh them against the respective volumes of business for making an allocation, you wouldn't have a widely variant answer from what I have.

Q. Just one more question now with regard to the allocation of income tax: I notice that you have allocated that in a definite proportion of the sales to each class, regulated and non-regulated, to wit, 90.19 per cent to the regulated sales. A. That is right.

Q. Now, you are aware that in the excess profits taxes that a portion of that revenue is taxed as high as 72 per cent.

A. I know that the rate goes up quite high on some of [fol. 10015] it. I don't know what the limit is now.

Q. In my question I should have included with the excess profits tax and the Federal income tax. And you have applied then to the unregulated business substantially 10 percent of the income tax, whereas the volume is 13.2 percent. A. That is correct.

Q. What is your idea in making an allocation of the heavy taxes against the non-regulated business?

A. I didn't allocate heavy taxes against the regulated business or against the non-regulated business.

The item of taxes is fixed by dollars subject to tax. The source of those dollars doesn't fix the tax. It is fixed by the amount of dollars, regardless of its source. I have allocated, therefore, the taxes on those dollars which were taxable in proportion to the source of those dollars, in proportion to the two businesses which caused those dollars to be made subject to tax.

Q. You have allocated here to the business which you say utilized—you have allocated to the non-regulated business the sum of $349,000 for the payment of taxes on a portion of the business which you say utilizes only about something less than 1 percent of the property.

A. No. I haven't said it uses only 1 percent of the property. I have estimated that of property, exclusive of [fol. 10016] production and gasoline property, there was caused an investment of about .16 percent of that property.

Now, I have followed precisely the same principle in the allocation of return that I have followed in the allocation of Federal tax, allocate them back in the proportion that the two businesses caused them.

Q. Well, you figured this, then, as two separate businesses? A. They are separate businesses.

Q. That is the basis—

A. (Interposing) And each one of them has several subdivisions.

Q. And that is the basis of your allocation, that they are two separate businesses?

Well, they are separate in this manner: that they are different classifications of the total business conducted. They are not separately and individually carried on. They are carried on simultaneously.

Q. Well, wherein arises the privilege of using the transmission system without expense to the non-regulated portion of the business?

A. They don't use it without expense.

Q. Expense for return.

A. In my allocation, they bear the expense of return upon the investment which they have caused.

[fol. 10017] Q. But not for the property which they use in distributing their gas?

A. For the property which they use for distribution of their gas alone they bear all the costs.

Q. Yes, but what do they pay in the return for transmission facilities that bring their gas from Texas to Hannibal, Missouri?

A. As far as the company's books are concerned, they don't set up separate charges for that. They don't attempt, so far as I know, to make a determination of the individual costs for delivery to any class of consumers, nor to any point on the system. Now, I think that could be done, but it hasn't been done.

Q. Well, what is the reason for not allocating a portion of the cost for the facilities used for transmitting your gas from Texas, let us say, to Hannibal?

A. None whatever, and I have made such an allocation.

Q. Of the facilities?

A. No, I have not allocated facilities. I haven't gone entirely through that process. In order to determine costs, it is not necessary to make a complete allocation of facilities to the various classes of business. I think, in some instances, you would be able to allocate facilities, but you don't need to do it in all the property.

Q. Is this a fair statement, then: that it is your thought [fol. 10018] in your testimony here that the pipe line company has a right to take such gas as it wishes to sell on direct industrial sales, and to utilize the entire transmission facilities of the company without any return upon them, and still have their income taxes paid at these high rates as a charge to the public for the gas they get through those same transmission facilities?

A. No, nor have I so estimated any such thing as that. I do think that they are entitled to transmit gas for direct sales without allocating part of their capacity against those direct sales, so long as those direct sales don't entail the construction of capacity. If they entailed a construction of capacity, they certainly ought to bear the cost of that capacity.

Q. A few months ago, did they not have to shut off some of their customers on account of a lack of capacity?

A. Yes, sir, they did.

Q. Well, then, somebody required some capacity, didn't they?

A. Yes, sir, they did, and during that period of cutoff which I have studied, I reached the conclusion fortifying my knowledge that they don't build capacity for this class of business that they had then no capacity for this class of business, and have none now for this class of business.

Mr. Culton: You mean for direct sales?

[fol. 10019] The Witness: That is right.

Trial Examiner: May I ask counsel whether, in your opinion, the Commission has the authority under the Natural Gas Act to require discontinuance of industrial sales

in order to serve communities which are connected and under contract, if the gas is required.

Mr. Culton: I don't think that power is given by the Natural Gas Act, Mr. Examiner, but the question has not yet arisen so far as Panhandle Eastern is concerned.

Trial Examiner: We are at the recess time, but I would like to suggest this question to Mr. Biddison, and perhaps he can answer it after luncheon.

At page 9942, where the letter of instructions to Mr. Spacek appears, you have listed 19 additional customers. I assume that in order to serve each of these customers, some investment was necessary.

Have you made any segregation or computation of the investment required solely for the service to those industrial customers?

The Witness: I have testified to that amount, Mr. Examiner. I had the amount determined for me by Mr. Spacek from the accounts of Panhandle Eastern Pipe Line Company.

Trial Examiner: Does that appear in Exhibit 251?

The Witness: That detail does not appear in Exhibit 251, but the details are available in the working papers of Mr. Spacek.

[fol. 10020] Mr. Culton: The aggregate, however, does appear, does it not, in 251, or do you recall? Give the figures to the Examiner: that is the important matter.

The Witness: The aggregate is $128,848.

Trial Examiner: And that represents the total investment necessary to convey the gas from facilities otherwise provided, or provided for other purposes, to these industrial customers?

The Witness: That is correct.

Trial Examiner: That includes your mains and any other facilities necessary to serve them?

The Witness: Yes; mains and any other regulating and measuring equipment.

* * * * * * * * * * *

[fol. 10021] Recross Examination.

By Mr. Littman:

Q. Mr. Biddison, the allocation study presented by you in Exhibit No. 251 is necessarily an estimate, is it not?

A. The allocation in Exhibit No. 251 was presented by Mr. Spacek. I supplied him with the instructions or basis for making the allocation. The amounts of money which are to be allocated have been explained in testimony by Mr. Spacek and Mr. Watkins.

Q. Mr. Spacek testified that he did not exercise any judgment in connection with Exhibit No. 251 but merely did a mechanical accounting job, as I understood his testimony. Is that your understanding of it?

A. That is right. He followed the rules which I set out.

Q. Now, these rules which you set out are essentially shown in Exhibit No. 251 under the column headed (C)?

A. That is correct. Those are condensed statements of the principles to be followed.

[fol. 10022] Q. Now, those principles represent necessarily the exercise of your judgment in each of the premises? A. They do.

Q. And are essentially estimates, are they not, as distinguished from the application of a particular set of rules or formula?

A. Well, the rules and formula are set out, in substance, in Column (C).

Q. What I am driving at and I think we will have no difficulty once I make myself clear which perhaps I have not, as yet, is this: That there are various methods of allocating expenses and returns, are there not?

A. Yes, sir, that is true.

Q. Various recognized methods, as a matter of fact?

A. Well, various methods are used. Some people recognize one set of rules as valid in one condition and another set is valid in another condition.

Q. And engineers differ with respent to various methods to be used or applied to a given set of circumstances, isn't that correct?

A. Sometimes that is correct, yes.

Q. Now, you have employed here chiefly the M.c.f. sales basis, have you not, that is, the annual sales basis?

A. No, not chiefly, no.

Q. You used that basis as shown on page 2 of Exhibit [fol. 10023] No. 251 as applied to natural gas production expenses, did you not? A. That is correct.

Q. You did not anywhere utilize the so-called demand basis or as it is sometimes called, the peak day basis, did you? A. Yes, sir.

Q. Where?

A. That has been used with reference to transmission expenses, both operation and maintenance.

Q. Where is that shown in Exhibit No. 251?

A. The detail of that is on page 3.

Q. Of the items that are shown on page 3, which are the ones to which you applied the peak day sales basis?

A. To 50 per cent of the pumping station labor, line 6; with respect to measuring and regulating station labor at line 9; with respect to measuring and regulating station supplies and expense, line 13; with respect to transmission mains labor at line 14; with respect to transmission mains supplies and expense, at line 17; it is involved over in the maintenance item of supervision and engineering, line 20; although that is not the sole basis; with respect to pumping station structures at line 22; with respect to measuring and regulating station structures at line 23; with respect to other transmission system structures at line 24; with respect to transmission mains at line 26.

[fol. 10024] Q. Just a minute. Let's look at line 25 for a minute. You have applied 100 per cent of those other transmission system structures to the regulated sales?

A. That is correct.

Q. Now, where does the peak day come in there?

A. The regulated sales constitute the peak day output in capacity.

Q. Are there any others, Mr. Biddison?

A. With respect to measuring and regulating station equipment, line 30.

Q. Are there any other bases other than the annual M.c.f. sales basis and peak day sales basis ordinarily used for allocation purposes?

A. Yes, there are a host of ways of making allocations.

Q. And there are a good many disagreements among engineers and I presume even accountants as to which is the proper method to use, isn't that correct?

A. No, I think the disagreeement is largely as to the matters of expediency in the application of the fundamental principles.

* * * * * * * * * *

Q. This allocation study which you have presented in Exhibit No. 251 represents, I take it, your best judgment with respect to the application of various methods of allo-
[fol. 10025] cation to the facts in this proceeding?

A. It does. At the same time, with a long series of investigations, there are some modifications that could logically be made. There is, in fact, some portion of production expense and some portion of the return on production property which could rationally be allocated on the basis of the requirements of the peak load. The amounts of those are small compared with the total amounts to be allocated and, in any allocation, some judgment must be exercised in situations similar to that in order to get a workable method and a workable answer.

I have tried, in this instance, where there were some comparatively minor items that could rationally be allocated on a demand allocation, to resolve the doubt in favor of throwing them into the commodity costs and have done so with those items of production property to which I referred and with some other items.

Q. I take it from your testimony that an allocation study is not necessarily an exact thing, is it?

A. There is nothing exact that I know of in engineering or science except the adding up of units.

Q. And a half a dozen very capable and equally expert engineers could very well take—

* * * * * * * * * * *

[fol. 10026] Q. (Continuing) could very well take the facts in this proceeding and come out with entirely different results in making an allocation study, isn't that a fact?

* * * * * * * *

The Witness: It is my opinion that expert engineers, making a serious attempt to fairly solve this problem would, among them, each have a different answer but that

the difference between the answers would be very, very small. They would arrive very closely at the same result if they followed the primary principle that costs are to [fol. 10027] be allocated against the service that causes the cost.

* * * * * * * *

Q. Well, you mean if they followed the same philosophy and principles which you have followed, they would come out with about the same results?

A. If they followed the principle which I have just enunciated, that costs should be allocated against the service that causes the cost.

Q. They do not all agree, do they, on that philosophy or the application of it?

A. Everybody that I know of that is competent to have an opinion on it does.

Q. Well, is the allocation study set forth in Exhibit No. 251 purely a mathematical matter or is it a judgment matter?

A. Well, as I have explained, the setting forth of the rules to be followed involved judgment. From that time on, it is a matter of mathematics.

Q. And engineers differ as to the rules to be followed in these allocation studies, do they not?

A. I suppose that some engineers would differ slightly in some of these rules as to specific quantities, yes.

* * * * * * * *

[fol. 10028] Q. Well, I take it, then, you are saying that yours is the only method that could be used for purposes of this proceeding?

A. I did not say that at all or even intimate it. On the contrary, I firmly believe that the fundamental principle which I have stated is sound and is acceptable to [fol. 10029] engineers who are competent to have an opinion on the matter. As to the detailed rules which I laid down, I have already stated that some variations from those would be had by other engineers.

Q. And the matter is, by and large, a matter of the exercise of judgment, is it not?

A. The fundamental principle is not a matter simply of judgment. The setting down of the rules for the han-

dling of individual amounts involves the use of judgment and that judgment must be based upon an understanding of the problem. That understanding can come by experience and that is where I got mine.

Q. It is therein that engineers disagree?

A. No, not wholly. That could quite well account for some disagreement.

Q. Within what over-all percentage limit would you say that you were exactly right in your allocation shown in Exhibit No. 251?

A. Oh, I think I am within 10 per cent either way.

* * * * * * * *

Q. Now, you have made a separation or allocation in Exhibit No. 251 as between the unregulated sales and regulated sales, have you not?

A. No, Exhibit No. 251 is not my exhibit, but Exhibit [fol. 10030] No. 251 does make an allocation between those two classes of business.

Q. Do you agree with Exhibit No. 251? A. Yes.

Q. If there is anything about it you don't agree with, I would like to have you point it out.

A. I have not disagreed with it. I have stated time and time again that it was made according to my instructions but I did not label it my exhibit because I did not prepare it nor did I present it.

Q. You take the responsibility for the philosophy behind this exhibit, don't you?

A. Exactly. I have taken it and I have testified I took it two or three times.

Q. And if Exhibit No. 251 is accurate mathematically, you take full responsibility for the result, do you not?

A. Absolutely.

Q. Well, assuming that Exhibit No. 251 is accurate mathematically, does it or does it not make an allocation as between unregulated sales and regulated sales?

A. It does make such an allocation. It shows on the face that it does and I have so stated that it did three or four times.

* * * * * * * *

[fol. 10031] Q. Are any of these unregulated sales to war industries?

A. I am sure that several of the industries in that classification are engaged in the production of materials used directly or indirectly in war activities.

* * * * * * * *

[fol. 10032] Q. What return does Exhibit No. 251 show is being earned on your allocated rate base, allocated to unregulated sales as shown on page 1 of Exhibit No. 251?

* * * * * * * *

The Witness: Page 1 does not show anything on that.

* * * * * * * *

Q. Well, look at line 42 under the column headed, "Non-regulated Sales," Column (F) entitled "Net operating revenue," $651,766.70.

Now, those are the net operating revenues, aren't they, according to Exhibit No. 248, and according to page 1 of Exhibit No. 251?

A. I do not have Exhibit No. 248 before me. I do not know what that shows right there but, on Exhibit No. 251, at line 42, Column (F), the net operating revenue for non-regulated sales is $651,766.70.

Q. Now, I want you to compare that figure with the re-[fol. 10033]turn which you have allocated to the unregulated business?

A. I have not allocated any return to it.

Q. Well, suppose we help you do it. Remember Mr. Chamberlain asked you to assume a rate base of $90,000,000. Do you remember that?

A. No, but I do recall he asked me to assume a rate base of some $84,000,000 and the Examiner suggested we take an example of $90,000,000.

Q. All right. Now, you have got the $84,000,000 from Exhibit No. 197 which amount is labeled, "Gas Plant—Consolidated"? A. That is right.

Q. Now, for purposes of convenience, suppose we just call it, as the Trial Examiner suggested, $90,000,000. Of course, when we use any such figure as $84,000,000 or

$90,000,000 we are making no deduction for depreciation, are we?

A. I do not know what you are doing but reaching out and getting a figure to use as an example.

Q. What figure did you start with when you started your allocation?

A. I did not start with any figure.

Q. Well, didn't you start with $84,998,335?

A. No, sir, I did not start with anything. I set down the rules and regulations to be followed by the man who made the computations and presented them.

* * * * * * * * *

[fol. 10034] Q. Suppose, before we make the assumption of a rate base of $90,000,000, I ask you to what use you put the $84,998,000 figure?

A. In the allocation of return, I apportioned that return over property values which totaled $84,998,335. That is not in Exhibit No. 251, however.

Q. That is right, Mr. Biddison. I think, perhaps, you did not get what I had in mind and perhaps I did not make myself clear. Perhaps I should have said in starting your method of allocating return, you started out with $84,998,000. Is that right? A. That is correct.

Q. Now, that represents the book cost of the gas plant of all these companies consolidated before any deduction for depreciation, doesn't it?

[fol. 10035] A. That is the property account as shown in Exhibit No. 197 by Mr. Watkins and any description further than that will have to come from somebody besides me. I think it has been explained.

Trial Examiner: Those are the figures that you adopted as the basis for the testimony you gave in segregating and allocating return, did you not?

The Witness: That is correct.

Trial Examiner: And did you not add to the segregated return the segregated base from which that return would derive? In other words, did you not break down the $84,000,000 plus in your previous testimony?

The Witness: Yes, I have broken that down in previous testimony.

Trial Examiner: What is the lesser figure?

The Witness: The lesser figure, after deducting the amounts for the gas and gasoline production property, is $79,774,894.

Trial Examiner: And that leaves, as a basis for earnings of $651,766.70 what sum?

The Witness: For the basis of earnings on property exclusive of that production property, $128,848.

Trial Examiner: No, you misunderstand me. The formula, as I understood your testimony, would be—and for these figures look at line 42 in page 1 of Exhibit No. 251—[fol. 10036] $84,000,000 plus is to X as $5,654,052.04 is to $651,766.70.

In other words, you segregated your return. Now, what is the effect of that segregation if you apply it to your base?

The Witness: Well, I will have to make a determination of base the first thing, Your Honor, because I have not made a determination of base.

Trial Examiner: You took the $84,000,000 for your base, did you not, in calculating your return?

The Witness: That is the total base that I started with in allocating return but I have not determined what that base would be as to either one of the classes of property.

Mr. Culton: That is the rate base.

The Witness: Rate base, yes.

Now, on the unregulated business, you would have $128,848, other than production property which you have in addition to that portion of the production property.

Trial Examiner: Is that not included in the $84,000,000 plus figure which has been given?

The Witness: Yes.

Mr. Culton: I think what the Examiner wants to know is the fraction which you used for the purpose of applying to whatever rate base the Commission shall select. I think that is what you are after.

The Witness: In substance what it amounts to and I think this will answer the Examiner's question, to [fol. 10037] determine from the $84,998,335 the respective rate basis conforming to the allocation of return which I have made, you should take 13.2 per cent of $5,223,461 of gas and gasoline production plant plus the item of $128,-848 of plant other than gas and gasoline production plant. That would be $498,497 of production property including gas and gasoline production property allocated to the non-regulated business and $128,848 of other property allocated to that business, the sum being $618,345.

* * * * * * * *

Trial Examiner: (Interposing) Just a moment, Mr. Littman. Exhibit No. 251, page 1, line 42, has a segregation of net operating revenues in which, under the column "Non-regulated Sales," Column (F), appears the figure of $651,766.70.

The Witness: That is correct.

By Mr. Littman:

Q. Now, what rate of return is indicated by that kind of a net earning as applied to a rate base of $618,345. Will you make the calculation for us, please?

A. About 94 per cent.

Q. Per annum? A. Yes, sir.

Q. Well, it is more than that, isn't it? Will you please calculate it again? It would be more than 100 per cent, [fol. 10038] wouldn't it?

A. Yes, that is correct. It is about 103¼.

Q. Percent return per annum? A. That is right.

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[fol. 10039] Mr. Goodman: In the opinion of the Commission in the Canadian River Gas case, it is said:

"The Commission is aware that in an investigation such as this, it is incumbent upon it to determine the reasonableness or unreasonableness of the rates and charges subject to its jurisdiction. This requires that the total costs of operations, including depreciation, taxes and a fair return be distributed among the various customers served individually or by appropriate groups. To the

extent that such costs allocated to sales under the Commission's jurisdiction are less than the revenues received, [fol. 10040] the rates and charges made are unjust and unreasonable and revenues must be reduced accordingly. It does not follow from this obligation of the Commission that an allocation of physical property or portions thereof must be made before any excessive returns are determined as seems to be the contention of the companies.*** All that can be accomplished by an allocation of physical properties can be attained by allocating costs, including the return."

Now, if I may be permitted to reword a phrase in the foregoing statement, I should like to do so. In place of the phrase "cost including return," I would like to substitute the words "revenue requirement". I make this suggestion because, to me and ~~I know to~~ many others, cost on the one hand and return on the other are distinct concepts whereas total costs, including the portion thereof allocated to depreciation plus a reasonable return, equal the revenue requirement.

I, therefore, repeat and endorse the following paraphrase of the last paragraph of the opinion referred to: "All that can be accomplished by an allocation of physical properties can be attained by allocating the revenue requirement. The latter method is by far the most practical and businesslike."

Now, I do not wish to assert or even endorse a quoted proposition without giving a reason for it. Briefly, it is this:

[fol. 10041] The allocation of a revenue requirement among classes of customers is in no sense a consequence of cost allocations. While differentials in the direct costs of each service, if free, must be recognized, and a fair test of their existence is the amount saved or avoided if the particular service is dispensed with, joint costs are the indivisible burdens of the total operations. Subject to the requirements that each unit should bear its direct or ascertainable avoidable costs, any different price classes per unit of service, that is, any different rates, must be the consequence of considerations of policy, not of cost. This

policy accords with the relative value of the different services which may be developed by the full utilization of the facility.

The opinion just referred to apportions the revenue requirement set by the fixed charges in accordance with the relation on the peak day of the customer's demand to the system peak. The evident object, which is approximated, is to apportion the general burden equally per unit of demand. There is nothing compelling about this policy. If at this equal price per unit the capacity is filled, the policy proves it is sound.

Now, I do not say this in disagreement with that policy. On the contrary, I say it is in fair accord with the application of that policy to that case and very likely to this case but in order to state and apply a general principle, that [fol. 10042] may be tested by the generality of its application and I do not believe that there is any general principle of law or of policy which brings one out to the necessary conclusion that, say, investment in transmission property shall be allocated equally in accordance with the ratio of the customer's demand on the peak day to the total peak demand.

I can conceive of occasions where that would not be a sound or even a business-like policy. Mr Biddison has gone to the far opposite extreme and has concluded that since there is no capacity whatsoever to be allocated to the non-regulated customers, they make no demand whatever on capacity, no capacity was provided for them. Therefore, no transmission line capital is to be allocated to them whatsoever.

But now let me cite a possible example that will bear on this question of allocation. As is well known and has been brought into the testimony in this case, a relatively small increased investment proportionately will pay for the installation of a very large quantity of increment capacity. That is to say that if the price of pipe line be roughly related to the diameter, a relatively slight proportionate increase in the [diaeter] will greatly increase the capacity of the line and if this line had been built, let us say, as a looped line of high capacity pipe, there would

have been plenty of reserve capacity in advance of the present demand and that reserve capacity would have [fol. 10043] been provided at a not impossible increased cost.

Now, let us suppose that there is an industrial customer on the line and he says, "Well, I will take your gas at, say, 15 cents per thousand cubic feet," and the pipe line company calls in its accountant and the accountant starts to figure on the basis of allocating an equal proportion of capacity relative to the demand of this customer on the peak day and the accountant figures out that if this is done, why, the gas will have to be sold at 15 cents per M.c.f. below the total allocated cost.

Yet Mr. Morton has shown to us that production costs and transmission or pumping costs are something around, on an average, 6 cents per M.c.f. and an average price, say, of 15 cents, will bring in 9 cents to relieve the burden of general costs and to afford some profit.

Well, if those figures be correct, I do not state them as correct but merely as general indications of a 9 cent differential between, let's say, the direct cost of the gas and what you are going to get, the businessman is entirely justified in taking on the business for, to him, the problem is, "Am I better off with this business than without it?" and he would be justified, as I know he frequently does—and now I am merely figuratively speaking—in throwing the accountant out the window. I do not mean this as a reflection on the accountant for there are, of course, many [fol. 10044] exceptions but I have heard numerous discussions and arguments between businessmen and accountants to precisely the same effect. The accountant's allocations have a certain tendency to prove that he is selling at a loss but the man operating the business knows that he is better off taking the business than leaving the business because he is going to have those costs anyway. The costs are there and whatever relief he gets is all to the good.

It is clear, then, that if there is plenty of capacity not being utilized and a new customer comes on and will take

some capacity, the question to be considered is not an equal division of the cost of that capacity among the users but this question, that this capacity that this particular customer is using does not have the same value as the capacity that a more necessitous customer is using. Now, I submit that is not any question of cost at all. I submit that one could start figuring from now to doomsday on the subject of cost and never approach a practical, workable solution of the problem. I submit that the efficacy of your cost calculations where joint costs are incurred and where they are inseparable is exhausted by using those costs for a determination of the total revenue requirement.

Now, having exhausted the efficacy of your cost work, your distribution of that total revenue requirement among customers derives and is derived from considerations of [fol. 10045] pricing policy as to where that burden should fall. Your Honor is undoubtedly familiar with the phrase, "what the traffic will bear" which has a primary reference to the subject under regard. I only point that out because it is perhaps better to refer to differences in the value of the service.

Now, let me try to relate this somewhat to this case. If it were possible to take one particular activity and compute the direct expense incurred in it, then the thing to do is to proceed in that way. Well, a customer uses up so much gas but we do not know what that cost is because that gas was obtained under a development project for a completed industry. There is no project in existence whereby fields are developed, gas wells are drilled, purely for a limited, we will say, 8 million M.c.f. per year capacity for non-regulated customers.

Now, a great field is developed. A pipe line is built in no sense for any limited operation but it is built not only for the customers of today but for the customers in the distant future. It is all engineered to handle great volumes and possess great capacities.

Now, I think that it may be assumed, even without argument, that gas can be sold and is being sold to the non-regulated customers at a price far below what would be conceivably possible if a separate industry had been estab-

lished for them. I think, on the other hand, that the de- [fol. 10046] votion of a certain proportion of the gas, and that is after all production and of the transmission capacity and I think some of it is devoted to non-regulated customers, to some extent cooperates with and relieves the burden of fixed charges which fall upon regulated aspects of the business or would fall anyway if the business were exclusively serving the regulated customers.

I, therefore, think that the direct charges that one can develop here are so small and so trivial as to cut absolutely no figure in the picture and that it is a complete and futile waste of time to attempt to find out how much labor, for example, is expended in serving the direct customers if it were even possible to do so and I doubt it is possible and how much production labor is devoted to extracting the particular gas which they require. The whole thing becomes very small. There are, of course, some laterals, which serve these industrial customers, as I recall the figure, about $125,000 worth, and also an infinitesimally small figure in this picture.

Now, following the Indiana Gas case which purported to do just exactly what I think should be done but finding in this case that there is no particular point in starting to make an attempt to allocate so-called variable costs or direct costs serving one or the other classes of customers, we get down to this situation which will do justice in this case with the minimum of trouble and which comports [fol. 10047] with good theory. We must first study the requisites of a rate structure and we must find out if the policy embodied in that rate structure is a sound policy. It has been mentioned that the company, in general, has a policy of pricing so-called good load factor gas at one price with a differential between that for poor load factor gas and that differential—I do not know the figures, Mr. Culton told me that it was 30 and 40 but I doubt whether that is right.

Is that right, Mr. Culton?

Mr. Culton: That is right. That is what most of them have. It is in the record.

Mr. Goodman: Let's assume, for the minute, that is the differential. In other words, poor load factor gas sells at three-quarters of the price of good load factor gas. Is that it?

Mr. Culton: No, you have that backwards.

Mr. Goodman: Poor load factor gas sells at approximately three-quarters of the price of good load factor gas?

Mr. Culton: Poor load factor gas sells at more than good load factor gas.

Mr. Goodman: Yes, poor load factor gas sells at one and one-third times what the good load factor gas sells for.

Now, in making differentials which, as I say, should accord with the relative value of the service, persons who know something about that should be consulted. The [fol. 10048] matter is not one for merely cloistered scholars. I would consult and pay rather close attention to the practical experience of the persons operating the business as to what those differentials should be for it is not a cost deduction at all. It is a policy deduction, a policy that is pursued by a gas merchant who has practical experience in his business and I do not mean to say, for that reason, that I am prepared to approve of everything or every conclusion that may come from the defendants in this case in that regard but I do say that, in a matter such as this, some attention should be given to what experience is shown on the subject because it is not a matter that can be figured out with a sharpened pencil.

Now then, if we have in mind that level of differentials which experience has shown will work as regard the development of the business and as adapted to a reasonable utilization of the capacity of the business, we should proceed to ascertain the demand of the non-regulated customer for poor load factor gas on the one hand and for good load factor gas on the other hand and then, on that basis, we may proceed to allocate the revenues.

That is to say, we take our differential of one is to one and one-third and we apply that to the total business, total sales to meet the price requirement. We will then

get a rate or a price per unit of service for good load factor gas and for poor load factor gas. That rate, con-[fol. 10049] sidering all the business is then the appropriate rate for the regulated business, it not being our concern what the company charges in the non-regulated business, where it cares to adhere to the price we set in the regulated business or not but we do know, and we use the same price in general because we apply the same policy for purposes of allocation, the differential between good load factor gas and poor load factor gas for our calculations. When we have calculated those revenues in that manner, we have accomplished our purposes. We could relate that to capital values. It would be a very simple proposition to transpose that into the capitalized amounts.

In my judgment, they would be correct, having in mind that correctness in this subject is conformance to an appropriate regulator or pricing policy and not to a delusive idea of cost.

* * * * * * * *

[fol. 10050] Mr. Culton: The Examiner made one suggestion a while ago as to our position on this exhibit.

I hope I made myself clear yesterday but, if not, I will try to do it at this time. We recognize that whether we can properly interpret the opinion of the Canadian River case or not, and whether the method of allocation which they used there is appropriate or not in this case, we do think that the Commission in that case clearly recognized that the best method of allocating was to allocate costs and that, in determining the allocation which should be made of costs, you should take into consideration an allocation of the return, whatever that return may be.

In that particular case, there was capacity in excess of all demands. In the Panhandle Eastern case, the demands are in excess of the capacity. Therefore, the ordinary coincidental rule or peak day rule would not apply. Here we have a deficiency in capacity if, in determining capacity you add the firm demand, that is, the resale gas, to our interruptible gas and, therefore, it becomes necessary for us to cut off interruptible gas during the peak days. As this witness has testified, the company does not have ca-

pacity in excess of its demands. This witness has presented what he thinks is a fair allocation of costs. If any-[fol. 10051] body else has a better method of allocating costs or any other method of allocating costs, it is appropriate for the Commission to hear it in this hearing.

Trial Examiner: Of your nineteen industrial customers, Mr. Culton, how many of them have contracts which make them subject to domestic requirements?

Mr. Culton: Every one, I think. I am informed that every one of our contracts, our direct sale contracts, is an interruptible contract without exception.

Mr. Littman: Mr. Examiner, I would like to be heard briefly on this subject of allocation.

I would like to express my opinion that this witness has not at all, in my judgment, followed the rules set forth by the Commission in the Canadian River decision. I shall undertake to demonstrate that either by cross-examination or by the introduction of testimony in rebuttal to Mr. Biddison's exhibit or Mr. Biddison's study or both.

The decision, of course, speaks for itself. I consider that the principle is stated on page 56 of the Commission's mimeographed copy of Opinion No. 73 which reads as follows:

"Commission staff exhibits on cost allocation followed principles that have long been recognized as reasonable in the public utility field and are widely accepted. Therein costs are divided essentially into two groups, fixed and variable. Fixed costs are largely joint costs which do not vary with the volume of sales. The total amount of such [fol. 10052] costs are largely proportional to the maximum demand on the system or system capacity. Accordingly, these costs have been allocated basically in proportion to each customer's responsibility for the peak day demand."

Mr. Culton: Would you mind interpreting that sentence, giving your judgment of it? Does that mean that if, on the peak day, our firm customers took all of our capacity and we were required to cut off all of our interruptible gas, then there would be no allocation of cost to the interruptible gas?

Mr. Wheat: That is our problem.

Mr. Littman: You mean where there is an interruption?

Mr. Culton: That is right.

Mr. Littman: Or curtailment?

Mr. Culton: That is right, talking about the peak day.

Mr. Goodman: I would like to answer that question, if you will permit me.

Mr. Culton: We would like to have the Commission's interpretation of it, if we can get it.

Mr. Littman: Of course, you will have that in greatest detail and in practical application very shortly. I would rather not undertake a general answer that may be misconstrued. I would prefer to present it either through cross-examination or direct testimony but I assure you our position will be made clear in detail.

Mr. Culton: Well, that is the thing that gives us difficulty.

[fol. 10053] Mr. Littman: I am glad to have you point out the part of this opinion which does give you difficulty because we may be able to enlighten you as to our detailed interpretation of that.

Continuing with the reading of the opinion:

"Variable costs are largely those that vary proportional to output or volume of sale. Accordingly, these costs have been allocated in proportion to volume of gas purchased by each customer."

Of course, there are other portions of this opinion which elaborate somewhat but, personally, I perceive the section that I have read to announce the principle. As I stated a while ago, I have in my own experience always looked at a result as one of the tests to determine the reasonableness of a method.

Now, according to this witness' method, he comes out with a result which shows, if these figures in Exhibit No. 251 are to be believed and if this witness' testimony is to be

believed, that the gross investment in plant applicable to these non-regulated sales, to-wit, the direct industrial sales, is $618,345. Exhibit No. 251 shows, in Column (F), line 42, that the net operating revenues, to-wit, the return applicable to non-regulated sales for the year ended 1941, amounted to $651,766.70. It is easy to see that the $651,776 represents a return in excess of 100 percent per annum [fol. 10054] upon the alleged gross investment applicable or allocable to the unregulated business according to the testimony of this witness.

Mr. Culton: Mr. Littman, do you know whether there is any difference in that situation which existed in the Colorado-Wyoming Company case so far as the allocation of return was concerned?

Mr. Littman: Certainly the Commission did not adopt this witness' method in that case.

Mr. Culton: I know, but on the allocation of return.

Mr. Littman: As I have heretofore stated, in my opinion the Commission does not and has not sanctioned any such method as this. I mentioned something with respect to profiteering. I firmly do not believe that the company is earning anything like 100 per cent return per year on its investment that is truly applicable to this business but that is where you come out when you use this witness' figures and if I may predict, I believe this witness who thus far has made estimates every one of which is either out the window, so far as this case is concerned, or so close to being out the window that it is almost there now, I would like to predict that this estimate will go the way of the others and will not be utilized.

I am going to urge very strongly that it not be utilized for purposes of this proceeding. However, when the time comes and we shall proceed to prepare ourselves for the eventuality of presenting for the Commission's considera- [fol. 10055] tion the staff's views on allocation, we shall present those views for Your Honor within the shortest possible time.

Trial Examiner: One thing that no one seems to have remarked about is the Commission itself makes a decision

between a company such as Panhandle or Natural Gas Pipe Line Company and a company such as the Colorado Canadian Company with its huge output to Colorado Fuel and Iron Company and affiliate. That is on page 1 of the opinion and that unusual relationship is commented on before anything is said about allocations.

Mr. Culton: That is true, Mr. Examiner. However, it is in connection with showing that the rates to industrials are not subject to the jurisdiction of the Commission.

Trial Examiner: They frankly recognize that in the opinion.

Mr. Culton: Yes and in the Colorado-Wyoming Gas Company case, on page 59, that does not, of course, relate to the industrial sales of the Colorado Fuel and Iron Corporation. They allocate those costs, that is, the costs of the Colorado-Wyoming Gas Company and the comment is made as to that. The principal purchaser, so far as Colorado-Wyoming Gas Company is concerned, is the Portland Cement Company and the statement is made that industrial gas is curtailed regularly during system peak days and they make this statement, "The demand on the system peak day is, in our opinion, a proper measure [fol. 10056] of its proportionate share of the demand costs than its highest off-peak demand."

Now, there is a possibility that if that sentence were the rule by which we would be governed, a considerable portion of Panhandle Eastern's gas would have no cost whatever attached to it.

We are not making that contention. I stated yesterday that, frankly, we do not know just exactly how the Commission allocated the return. We have presented here a method of allocating return which we think is a fair method.

Mr. Littman: In answer to your Honor's inquiry, I would like to point out that in the Canadian River case, the total volume of direct industrial sales was quite considerable. Here, according to Exhibit No. 251, the amount of direct industrial sales sold on an annual M.c.f. sales basis is approximately 13 per cent to non-regulated business

and, on a revenue basis, it is approximately 8½ per cent so we do not have here nearly so large a volume of gas not subject to regulation as was the fact in the Canadian River case.

In the Chicago Pipeline Case or the Natural Gas Pipeline Company of America proceeding, my understanding is that there was a very small percentage of direct industrial sales, something in the vicinity of one or two per cent, perhaps, and no allocation whatever was made there, so far as I know.

Mr. Culton: And no evidence was offered on that, either?

[fol. 10057] Mr. Littman: That is my understanding also, Mr. Culton. No evidence was offered by the company or the Commission, as I gather it.

Mr. Culton: That is right.

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[fol. 10064] By Mr. Littman:

Q. Mr. Biddison, do you know whether it is possible for a company to earn more than a hundred percent per annum under the existing tax laws? A. I do not.

Q. Do you know how much of the capital stock tax and excess profits tax a business earning more than 100 percent profits per annum would have to pay?

A. I do not.

Q. How much have you allocated to non-regulated sales for capital stock tax?

A. Federal capital stock tax has been allocated [fol. 10065] $4,706.53 to regulated sales, and $11,388.97 to non-regulated sales.

Q. That appears on page 5 of Exhibit 251 in Lines 17 and 18. A. Yes, sir.

Q. How much have you allocated to non-regulated sales for excess profits associated with capital stock tax?

* * * * * * * *

A. Well, Federal excess profits taxes have been allocated $3,209,166.84 to regulated sales and $349,062.28 to non-regulated sales.

By Mr. Littman:

Q. Now, is the sum of $349,062.28 which you just mentioned the proper amount allocable to non-regulated sales for excess profits tax associated with capital stock tax?

A. I don't know about the association you are referring to. I think that is the proper allocation of this amount of tax.

Q. Do you know whether or not you have allocated any [fol. 10066] excess profits tax associated with capital stock tax applicable to non-regulated sales?

A. What I have allocated are the amounts shown in Column B. As to their association, one with the other, I don't know.

Q. Then, you don't know whether you have done it or not, do you?

A. I think I have answered your question. I have simply allocated the amounts shown in Column B. What their association is, one with the other, I do not know.

Q. Well, will you state whether you have or have not allocated to non-regulated sales a business which shows 100 percent return per annum on the gross investment for excess profits tax associated with capital stock tax? Have you or have you not?

* * * * * * * *

Mr. Culton: Counsel is talking about a non-existent item that isn't listed on the exhibit at any point.

By Mr. Littman:

Q. Do you know that to be a fact, Mr. Biddison, what Mr. Culton has just said?

A. No, I don't. What I have done is to allocate the [fol. 10067] amounts in Column B. As to the association of one with the other in the respect that you have mentioned, I don't know anything about any such association.

Q. Do you know whether a business earning a hundred percent on its investment would have to pay such an excess profits tax associated with capital stock tax?

A. I do not.

Q. How much have you allocated to non-regulated sales for excess profits tax associated with Federal income tax?

A. I have allocated excess profits tax as shown in the exhibit, or had them allocated as shown in the exhibit. As to the association of the one form of tax with the other, I know nothing about the association.

* * * * * * * *

[fol. 10076] Earl B. Coffman was called as a witness, and, having been first duly sworn, was examined and testified as follows:

Mr. Wheat: Mr. Examiner, I should like to have [fol. 10077] marked for identification two documents.

* * * * * * * *

I should like to ask, Mr. Examiner, if it will be agreeable to you, that the document entitled "Study Relative to Minimum Requirements of Panhandle Eastern Pipe Line Company (giving effect to property acquisition)" be marked for identification with the next exhibit number.

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(The Document Referred to Was Marked Exhibit No. 253 for Identification.)

Mr. Wheat: And in order to save time, I should like to [fol. 10078] ask also that at this time there be marked for identification as Exhibit No. 254 the document entitled "Investors' Appraisal of the Risks of Capital in 153 Stable Industrial Companies for the Years 1937-1941, inclusive, (also it contains 1941 full year data for the Utility Industry supplemental to Exhibits 63 and 64.)"

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(The Document Referred to Was Marked for Identification Exhibit No. 254.)

Direct Examination

By Mr. Wheat:

Q. Mr. Coffman, you have already been sworn in these proceedings, have you not? A. I have.

Q. Now, since you appeared at a prior date in these proceedings, have you made further analyses?

A. Yes, I have. And the analyses contained in the Exhibit No. 253 and the supporting data to certain of the charts contained therein are presented in Exhibit No. 254.

Q. In order that we may conserve time, Mr. Examiner, I should like to ask Mr. Coffman at this time, please, briefly to restate for the record what you have done in making this analysis.

A. Well, the purpose of this analysis was to present [fol. 10079] factual and objective data on the minimum earnings requirements to maintain the credit position of the company, and enable it to secure capital when needed, giving full consideration to the bonds, preferred stock, and common stock of the company under its present status, after acquiring various properties as of February 6, 1942.

Trial Examiner: Before you leave your Exhibit 253 for identification, will you kindly relate that and the other exhibit to the exhibits you previously offered, namely, Exhibits 63 and 64 and 65, I think?

Mr. Wheat: May I make the suggestion, sir, I think that as the discussion proceeds, the relation of Exhibits 253 and 254 for identification with Witness Paul Coffman's previous Exhibits 63 and 64 and 65 will become evident, and I think it would both conserve time and add to the understanding of what Mr. Coffman has done if he could proceed in this connection as we have done, and explain at each individual point the relation between the exhibits shown.

Trial Examiner: Thank you.

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By Mr. Wheat:

Q. Then, Mr. Coffman, will you proceed with, I think, the statement that you had begun, of what you did in [fol. 10080] making this analysis, the results of which appear in Exhibits 253 and 254 for identification?

A. Well, as we all know, the important relationship between return and capital and the total costs of rendering service is due to the relatively large proportion of fixed capital which is required in the utility industry.

The average public utility, for example, requires a plant investment equal to from four to six times its annual gross revenues, whereas the annual gross revenues of most industrial corporations ordinarily exceed this total investment.

In view of the fact that variations of huge monetary amounts may thus result from relatively minor fluctuation in allowed rates of return, it is apparent that too much care and attention cannot be devoted to the factors upon which that rate must itself be predicated.

As I stated when I appeared before this Commission a month or so ago—

Q. You mean about last October, was it not?

A. Well, several months ago, as a matter of fact, now.

(Continuing) —I had reviewed the leading cases on the subject to ascertain what body of principles had been amassed and used for determination of the proper "return," but it seemed to me that in many instances necessary facts had never been available to do what the Court [fol. 10081] said should be done, and at that time I cited the portion of the Bluefield case to which I referred, and which I thought gave a body of principles that was usable for the analysis I presented particularly in Exhibit 65, and which analysis I have brought down to date in Exhibit 253, and that portion was the statement which I quote from the Bluefield case: "A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties."

Mr. Wheat: Mr. Examiner, may I, off the record, correct his statement?

I believe that the word "general" as you read in here, does not appear.

Does it appear?

The Witness: It appears in the same general part, is that what you mean?

Mr. Wheat: Yes, all right.

A. I believe that is exact. I checked it a couple of times.

Mr. Wheat: All right.

[fol. 10082] By Mr. Wheat:

Q. Now, did you attempt to present data on that subject in Exhibit 65?

A. I did. In my Exhibit No. 65, I presented data on this subject and in my present exhibit, which is now No. 253, I have expanded the data so that one would have the relevant facts upon which to exercise one's judgment.

For example, I have attempted to measure the risks and uncertainties attaching to other business undertakings at the same time and, in so far as data are available, in the same place.

My method, as will be shown later, treats of this latter in a substantial and substantive way, although it may not be apparent on its face. The reason for this is that what I call investors' appraisal has as one of its parts the market prices of securities

Various kinds of investment possibilities are available to investors who finally make a selection, all available facts taken into consideration, such as risk, uncertainty, geographical areas, type of service, type of product, and so forth.

It is my belief that so far as available facts are concerned, I have presented all the relative ones so that a person can exercise enlightened judgment.

Q. You mean all the relevant facts. "Relative;" I [fol. 10083] think you said.

A. All the relevant ones, yes.

Q. Now, what else have you to say as to what you formerly quoted in the second sentence from the Bluefield decision?

A. Well, in the Exhibit 65 at the time I was testifying, I said I further relied upon that portion of the Bluefield case which is stated as follows; "The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under

efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties."

In so far as the efficiency of management can be measured by the operating results of the company as compared with the results of other companies—and I think this is by far the most reliable method—I made sufficient analysis to lead me to the conclusion that its management was efficient.

My end finding, which I call "Minimum Return Requirements" is based upon this belief, and supplies all the relevant facts on this subject dealing with the return being sufficient to assure confidence in the financial soundness of the utility and maintaining and supporting the company's credit and enabling it to raise the money nec- [fol. 10084] essary for the proper discharge of its public duties.

As a matter of fact, I do not see how a determination on return, as defined above, can be made without using the data contained in my present exhibit which is now No. 253.

I should like to emphasize the fact that so far as the company's credit, risk factors, and so forth, are concerned, it does not make any great difference what I think or what the management of the company thinks or what those of us here present think. The real fellow to tell us about this matter is the man outside who is going to put up the money. He is the person to tell us what the credit risk is and he is the person who will insist that certain yields be granted him or he will not put up the money. In the end, therefore, it is the investor, as a class, who determines with finality what return is necessary.

What I have tried to do in Exhibit 253 and the supporting tabular data give in Exhibit 254, is to show, as completely and fully as possible, what the investor is saying about these factors of risk, management, financial soundness, and raising new money, and I believe that if companies wish to continue to finance through public offerings, it will behoove them to look at this investors' appraisal in these matters.

In other words, all of the elements of risk affecting a particular enterprise are ordinarily reflected in its costs [fol. 10085] of capital which are determined by amounts which must be paid to investors to induce them to supply the capital needed in the enterprise.

Q. Mr. Coffman, in developing your present analysis, what, in general, did you do?

A. Well, primarily, I used my former general approach as presented in Exhibits 63, 64, and 65 to this problem of return, and I have set forth the earnings required to maintain the capital of Panhandle Eastern Pipe Line Company giving consideration to the securities which have been issued since my former testimony.

In other words, this includes now all the events that have taken place which are recorded as of February 6 in the acquisition of these new properties.

Q. By that do you refer to the new bonds and the new preferred stock which were issued in connection with the acquisition and purchase, we may say, of Michigan Gas Transmission Company, and Indiana Gas Distribution Company properties?

A. Yes, I refer to the $10,000,000 in bonds and the $15,000,000 in new preferred stock that was issued in connection with the purchase of Michigan Gas Transmission Company and Indiana Gas Distribution properties, and a small amount of property of Ohio Fuel Gas Company, and the amount involved to refund the former class A preferred stock.

[fol. 10086] Q. As of February 6, 1942?

A. As of February 6, 1942.

Q. In other words, are we to understand that you have here given effect to these transactions and reflect the situation as we now find it in respect to Panhandle Eastern Pipe Line Company?

A. That is exactly correct.

Q. Now, in consideration particularly of the Trial Examiner's suggestion, I wish you would refer to Exhibit 65 and state to what particular charts in that exhibit you would say that your new study, as reflected in Exhibits 253 and 254, refer?

A. Well, I am referring in Exhibit 65, Charts Nos. 36 and 37, to the column and the figure which bears the caption "Current Capital Requirements."

Q. Now, those charts 36 and 37 in Exhibit 65 refer, do they not, to Panhandle Eastern Pipe Line Company as it existed prior to February 6, 1942?

A. That is correct.

Q. Now, in what way would you say that your present study differs from that which is reflected in those charts 36 and 37 of Exhibit 65?

A. Well, in Exhibit 65, I went beyond the earnings required to maintain the company's capital and credit—that is, the item usually denominated "return"—and took [fol. 10087] data from the published sources in respect to operating expenses, labelling the final figure "Total dollars needed by management". Such column and caption is also shown as the left-hand bar on each of the Charts Nos. 36 and 37 in Exhibit 65. In the present study numbered Exhibit 253, I made no attempt to determine this total figure of overall needed earnings, but confined myself to the factor of return.

That is, the amount of revenues required by this company as it now exists, and in its present status, over and above the requirements for basic operating expenses, depreciation and taxes.

Q. Why did you make this present analysis on that basis?

A. Primarily because the time available for study was so short that I found it impossible to develop data beyond that involved in the item of return, that is, the earnings necessary to maintain the credit position of the company.

The fact is that was only by working a large staff both day and night that I was able to have the six copies of Exhibit 253 completed, which has been presented at this hearing.

Q. Now, would you say that there are any further differences which ought to be explained now at the outset between your present analysis in Exhibits 253 and 254 [fol. 10088] and the analysis which you presented in Exhibit No. 65?

A. Yes, there are certain differences. In the present analysis, as shown in Exhibit 253, I have given no time and have presented no charts in regard to the general trends in the industry as was shown in Exhibit No. 65 in Charts 2 to 6, inclusive, and I have made no comparisons of Panhandle Eastern Pipe Line Company's gross revenues and its operating revenues with industry figures—

Q. (Interposing) Operating ratios?

A. (Continuing) And its operating ratios.

with industry figures as shown on Charts Nos. 7 and 8 of Exhibit No. 65.

Q. I wish you would state why you omitted those particular items.

A. Well, as I recall it, in the course of the discussion in the last hearings, no question was raised in regard to the trends in the industry or the comparison of Panhandle Eastern Pipe Line Company's figures with industry figures; consequently, I did not feel it was necessary to include these items in my present analysis as shown in Exhibit 253, since it was already included in numerous charts.

However, so far as the industry figures are concerned, I have included, as Table No. 1 in the tabular section of tables, showing latest available figures, which when considered with tables presented in Exhibit No. 65, would [fol. 10089] bring the tabular material down to date in case any question should be raised as to what any figure might be.

Q. Well, in other words, you have included in the appendix to Exhibit 253 the basic data upon which the charts you have just mentioned in Exhibit 65 could be brought down to date?

A. The very last table captioned "Appendix Table No. 1" in Exhibit 253 contains all the data on the industry figures shown in Charts 2 to 6, in Exhibit 65, that I could find which became available since that last study in Exhibit 65 was made.

Q. Are there any other differences between your present study and the analysis that you presented in Exhibit

65 which you think should be drawn to the attention of the Commission?

A. Well, with the exceptions noted above, my approach is generally the same in this study as that shown in Exhibit No. 65.

However, in the present analysis in Exhibit 253, I have expanded the period covered in certain charts over that which was covered in similar charts in Exhibit No. 65 because my present study is based largely upon figures contained in Exhibits offered through Mr. Watkins, while in my prior analysis, contained in Exhibit No. 65, I took all of my figures so far as the company was concerned, [fol. 10090] from annual reports to stockholders and other published data, the first of which available to the public covered the year 1934. Consequently, my prior analysis was more restricted so far as Exhibit No. 65 was concerned than is true in the present analysis as shown in Exhibit No. 253.

Furthermore, by confining my attention to one item, namely, earnings necessary to meet capital requirements, I was able to make a more detailed analysis of certain items with the result that my present study includes certain items which were not shown in Exhibit No. 65, such as detailed analysis of 153 industrial companies which have paid dividends continuously over a 10-year period and analysis of the various natural gas pipe line companies and the effect upon quality ratings of their securities as the result of certain assumed alterations in their revenues.

[fol. 10091] Q. Would you say, Mr. Coffman, that what you have now stated generally describes the major differences between your present study and that contained in your exhibit 65?

A. Well, broadly speaking it does. However, you realize I have not attempted to particularize by chart number but have covered the subject generally.

On that basis I think I have outlined the principal differences.

* * * * * * * *

Q. Now, Mr. Coffman, just one more question before I leave this subject:

Is the impression that may have been gained from what you have said correct that all of the figures relating to the company, with the possible exception of one or two minor items, are based upon figures which Mr. Watkins has testified to in this record?

A. Yes, sir. That statement is correct.

You will find the references to Mr. Watkins' exhibits in the sheets of supporting data referable to the various charts in my present exhibit No. 253, and I followed the same procedure that I did in my exhibit 65, namely, in [fol. 10092] the back portion of the exhibit there is a table supporting each chart where a table is necessary, and each table is completely sourced as to data, so that it can be told exactly what figures I am using and from what source I took those figures.

Q. Now, as a result of this study, Mr. Coffman, what figure have you determined to be necessary to meet capital requirements and maintain this company's credit as of February 28, 1942, based on the figures for the consolidated company?

A. According to my determinations, $5,382,677, as shown in chart No. 26 of Exhibit 253 would be required on the consolidated basis, and that figure compares with $5,064,821 for Panhandle Eastern Pipe Line Company alone, as of June 30, 1941, as shown in chart No. 37 in my exhibit No. 65.

Q. When you refer to the first figure you have just stated, you are referring to net income, are you—net operating income?

A. That is the minimum earnings that are necessary to maintain capital requirements, yes, sir.

Q. Now, does this new figure $5,382,677 reflect all property or security acquisitions made by the company prior to February 28, 1942?

A. Yes, it does.

Q. And this figure is after taxes but before interest?

[fol. 10093] A. That figure is after taxes, that is correct.

Q. But before interest? A. That is correct.

Q. Now, without at this moment discussing the detailed construction of this figure, I would like to ask you why you believe such a figure as this should be determined at the outset, and why you believe it must necessarily be considered as you have said in a rate of return determination.

A. Well, as I have outlined a few minutes ago, I feel exactly the same now as I felt at the time I testified before this Commission some months ago, so far as the figure representing dollars needed to meet current capital requirements is concerned.

In determining such figure I believe I am following to the letter, as I stated before, the principles of return determination as laid down in the Bluefield Waterworks and Improvement Company vs. Public Service Commission of West Virginia.

Q. You are referring to the case reported at 262 U. S. Reports 269? A. That is correct.

Q. All right. Proceed.

A. Among other things, in regard to determining an annual rate, the court there said:

"The return should be reasonably sufficient to assure [fol. 10094] confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties."

All I have done, as I see it, is to follow a literal interpretation of that statement and present my conclusions objectively in statistical and graphic form.

I believe the Bluefield case stated most clearly the various factors that should and must be considered in the determination of an annual rate, and it was my further belief in that case, and I quote:

"What annual rate will constitute just compensation depends on circumstances and must be determined by the exercise of fair and enlightened judgment, having regard to all relevant facts."

So far as I am concerned, confining my attention to the financial soundness and corporate position of the com-

pany, I think I have given full, fair, and adequate regard to all facts relative to this particular phase of the problem.

Q. I note, however, Mr. Coffman, that you have not related your figure of return to any rate base. Why did you not do that?

A. Well, I had various reasons. I think I explained before, in connection with Exhibit No. 65.

[fol. 10095] The main one is that th use of a rate ba e, however it be obtained or measured, d the multiplying of that base by a so-called rate of retu n, comprehends merely one method of arriving at the final end figure of required return in dollars.

I was able to arrive at that figure directly without going through the mathematical process of multiplying a rate base by a percentage rate of return.

As a matter of fact, whatever figure were to be adopted as a rate base—let us, for example, say prudent investment—you would have to make the very studies I have made in order to determine the proper percentage by which to multiply it.

In other words, I have merely done directly what the classical rate base times rate of return method must do indirectly, if a correct result is to be obtained under the Supreme Court's pronouncements in respect to requisite return.

In either case you must arrive at the same result in dollars of required return if you do a fair and proper job in the light of the economics and the objective data.

Q. Now, Mr. Coffman, if you were to be asked to assume a rate base, how would you go about developing the element of fair return?

A. I would make exactly the same studies which I have made, and then I would divide the required return in [fol. 10096] dollars by the assumed rate base.

This would give me the percentage of fair rate of return.

Q. I take it, then, that you are not objecting to the use of the so-called classical method?

A. No. I think I discussed that before in connection with Exhibit No. 65, and I think I said that I didn't see any particular necessity for going through that mathematical process when you can get your end figure directly.

Q. I want you to make it perfectly clear on this record just why you think that is true.

A. For one reason—and I believe it is a compelling one—and that is to do the job properly one must make the economic studies, the objective economic studies, of what such a company must have in order to maintain its credit position and thus be able to go forward and continue to render the service required of it, and when you have done that you arrive at the end figure directly and don't have any further arguments about rate base or rate of return.

Q. Now, just to be sure that the record is clear: What is the rate of return that your study indicates to be required in this present proceeding?

A: I can't answer that. I don't know what the rate base is.

Q. Well, now, I will give you an opportunity. Let us [fol. 10097] assume, for the moment, for the purpose of this question, and purely as an example, as has been done in other questions in this case, that you arrive at a rate of return by taking the total gas plant classified as shown on Mr. Watkins' Exhibit 200—

Mr. Littman: You mean "rate base"? You said "rate of return".

The Witness: I am sorry. Rate base.

By Mr. Wheat:

Q. If we take the total gas plant classified as shown on Watkins Exhibit 200 of, I think, $78,700,000 approximately, and we then reduce it by the reserves for depreciation and depletion, which are in round figures $13,097,700 as shown on Exhibit 197—I believe both of these figures are February 28, 1942—now what would you have to say about a rate of return?

A. Well, using those figures the net plant would then total $65,600,000 in round figures.

Applying my rate of return—

Q. (Interposing) Do you mean your rate of return?

A. My required return. (Continuing)—of the $5,382,677 as shown in chart No. 26 of Exhibit 253 to the base gives a required rate of return, in percentage, of 8.2 per cent.

[fol. 10098] Q. Now, suppose that, for some reason, the Federal Power Commission, in fixing rates for Panhandle Eastern Pipe Line Company, were to desire to use some other figure than we have thus assumed for the rate base: how would that affect your testimony as to the required rate of return?

A. Obviously the results would change if any base figure used in the calculation changed.

If there was a reduction of the net investment figure by an amount it would therefore reduce the rate base by this calculation made.

In that case I would apply the figure of $5,382,000 of required return in dollars to the lower rate base, and arrive at the percentage which the one bears to the other.

That percentage would then be the required rate of return.

Q. And would that same fact hold good, or the same machinery hold good, if the Commission wished to increase that rate base?

A. It would work exactly the same.

Q. Now, do these examples bear out your opinion what you have said in respect to your method as the direct method, as compared with the classical method which I think you referred to by the term "indirect"?

A. Yes, as I have testified, under either method you must eventually come out with the number of dollars [fol. 10099] needed by the company as earnings over and above its reasonable operating expenses, its taxes, and proper accruals for depreciation, depletion, and amortization.

The end figure is what you have after and what you must—

Q. (Interposing) "What you are after" don't you mean?

A. The end figure is what you are after and what you must somehow secure.

My method uses the basic objective studies that must be used to reflect the economics involved, and while, as I have shown, I can go through the process of determining fair rate of return upon any given rate base, that is not a necessary piece of machinery, and the whole process is simplified by using direction instead of indirection.

As a matter of fact I have included a chart in this exhibit No. 253 which makes this point very clear.

Perhaps I could start discussing the individual charts and let further development of this idea come out as I proceed.

Q. Well, I think that is a good idea.

Now, with that in mind I would like to ask you now to turn to Exhibit No. 253 and state first whether you have included, at the outset, an index of the charts and tables for the convenience of anyone considering this document.

A. Yes. There is such an index included in Exhibit [fol. 10100] No. 253.

Q. I notice that the next general section of that exhibit is headed "Graphic Presentation".

I wish you would turn to what you have labeled "Chart No. 1" in that graphic presentation and state what that chart shows.

A. In Chart No. 1, Exhibit 253, captioned "Condensed Actual and Pro Forma Balance Sheets of Panhandle Eastern Pipe Line Company as of December 31, 1941", I show two columns of balance sheet figures, one column captioned "Actual" and the other captioned "Pro Forma".

The pro forma figures give effect, as told in the note, to financing transactions consummated on February 6, 1942, and the acquisition on that date of capital stock and debt of Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation, and purchase of certain property of Ohio Fuel Gas Company.

The two columns are self-evident.

Looking at the total asset figures for the moment, the actual figure shows $79,000,000 in round figures, and the pro forma statement shows $96,800,000 in round figures.

Q. This all is as of December 31, 1941, is it not?
A. Yes, it is.

A breakdown of the important classifications shows that assets on the actual basis totalled $69,650,000, and [fol. 10101] this is including the net intangibles.

Q. Do you not mean, Mr. Coffman—rather than the assets—that the gas plant included in the assets totalled the figure you just gave: $69,650,000?
A. I don't recall what I said. What you say is perfectly correct.
Q. That is correct, is it not? A. Yes.
Q. Will you proceed?
A. And in the pro forma the same item carries a dollar figure of $82,952,000 in round figures.

The only other item in the total asset group is under the caption "Current and Accrued Assets," which in the "Actual" column totalled $8,959,000 and in the pro forma totalled $13,418,000, and that particular item carries a footnote explaining that the investment in tax anticipation notes, amounting to $2,750,000, was included in the current asset group.

Q. Now, there are two other items under "Assets", but I don't believe it will be necessary for you to mention those for the record: they are self-explanatory.

We now turn to the item of "Liabilities and Capital." State what, in general, are the main differences between the "Actual" as of December 31, 1941, and the "Pro Forma" as of that date, giving effect to the acquisition of [fol. 10102] properties and securities made February 6, 1942.

A. The main differences, as shown, between the Actual and Pro Forma occur in the preferred stock items, which under Actual totalled $11,000,000, and under Pro Forma is $16,000,000, under the caption "Long Term Debt" which in the Actual column was $23,259,000 and Pro Forma was $33,259,000.

Q. That is because—is it not—of the increase of bond issue by $10,000,000? A. That is correct.

Q. Proceed.

A. The other item that has any appreciable change is that captioned "Reserve for Depreciation, Depletion, Amortization, and so forth," which in the Actual Column totalled $10,900,000 approximately, and in the Pro Forma was $12,598,000, and I merely presented those data in Chart No. 1 to contrast the Panhandle Eastern Pipe Line figures only with the new situation after the acquisitions as shown in the Pro Forma column.

Q. Well, in general would it be fair to say that what has happened is really an increase in the assets and the accompanying liabilities of Panhandle Eastern Pipe Line Company from $79,000,000 approximately to something just slightly under $97,000,000?

A. I think that is correct.

Q. I think, Mr. Coffman, there are some other minor [fol. 10103] changes that come about by virtue of consolidating the figures, but are the ones which we have mentioned the most important, so far as your analysis is concerned? A. Yes, they are.

Q. Now, I wish you would turn to your chart No. 2 which I note consists really of four separate subcharts. I wish you would state to what chart in your Exhibit No. 65 this chart No. 2 refers, and then explain in some detail what you have shown on chart No. 2.

A. Chart No. 2, captioned "Trend of Revenue and Expenses of Panhandle Eastern Pipe Line Company, 1932-1941," and Pro Forma in Exhibit 253 contains the same information—that is, similar information—to Chart No. 9 in Exhibit No. 65—in chart No. 2 of Exhibit 253 there are these additions, because on this study I had company data available, as already explained, by virtue of Mr. Watkins various exhibits.

Q. Where does that show up?

A. What do you mean?

Q. That shows up all through your figures, does [—] not, but does it particularly show up in the earlier years?

A. Well, what has happened is that under Mr. Watkins' exhibits I have been able to add figures for nine months of 1932 and all of 1933, which were not available before and have been able to add the 1941 full year figure,

[fol. 10104] and have been able also to show the pro forma after the acquisitions.

Q. Yes. You were enabled to do those things by receipt of the data from Mr. Watkins, which he has placed in evidence in this case; is that true?

A. That is correct, and as I have explained before, if one refers to the back of Exhibit 253, to table supporting chart No. 2, wherein are contained all of the figures, there is an item at the bottom captioned "Source" which says: "Watkins Exhibits No. 173, 195, 198, 199," and computations are made by Standard and Poor's Corporation, which are merely these percentage calculations which have been added as I analyzed the figures.

Q. Were those computations made under your direction? A. Yes, they were.

Q. I think you previously stated that you are an officer of Standard and Poor's Corporation.

A. I am a vice-president and director of Standard and Poor's Corporation.

Q. Now, will you turn to the upper left-hand subchart contained on chart No. 2, which is headed "Gross Revenue," and state in general what that shows?

A. Well, I don't think, in discussing these data, that it is necessary to go through the various years.

Q. No.

[fol. 10105] A. I have explained the additions.

Q. I don't want you to do anything that you don't feel is necessary, so that this will be completey understood in the record.

A. The important figures really are contained in that box captioned "Gross Revenue" in the last three columns, namely the red bar, which is the 1941 figures. Actual, for Panhandle Eastern Pipe Line Company alone, which were not available when I made the analysis for Exhibit No. 65, and that figure amounted to $15,434,858.

The next figure is the 1941 figure on the Pro Forma, and that figure totalled $17,789,573.

The second blue column, or the last bar in the section, "Gross Revenue," shows the actual consolidated figures for the year ended February 28, 1942, and that figure totalled $18,378,378, and those figures, as I have stated, are from Mr. Watkins exhibits.

Q. Now, Mr. Coffman, looking at this chart of Gross Revenue, and at the gradual increase which is shown, would you conclude that this company is still a growing enterprise?

A. I think that a fair interpretation of the trend of the data is exactly that.

The 1941 figure, for example, on Panhandle Eastern Pipe Line Company, prior to acquisition, showed quite a marked growth over 1940, and the 1941 figure, Pro [fol. 10106] Forma, for the consolidated picture showed a larger amount.

It would seem to me that it was fair to say that the company was still in a growth stage.

Q. Now, looking at the right-hand box, or subchart at the top of Chart No. 2 on Exhibit 253, I wish you would state generally what that subchart shows.

A. That particular division of chart No. 2 contains the operating expenses before taxes, and the more important figures there again, aside from the earlier ones that have been added, is the full year 1941 for Panhandle Eastern Pipe Line Company alone, which figures totalled $5,827,828.

The 1941 figures on a pro forma basis show $6,635,138, and the Actual figures for the consolidated company, as of February 28, 1942, of $6,758,914.

In addition to those specific amounts, which were presented in Mr. Watkins' exhibits, I have calculated the per cent of the operating expenses before taxes to gross revenue, which shows that the actual 1941 figures for Panhandle only were 37.8 per cent.

The 1941 figure, pro forma, 37.3 per cent, and the actual figure for the consolidated company, for the year ended February 28, 1942, 36.8 per cent.

Q. By the way, Mr. Coffman, your figures shown in the bars running along the bottom of this particular subchart include general operating expenses, and the depre- [fol. 10107] ciation, depletion and amortization charges?

A. Yes, sir. That is correct.

Q. All the operating expenses, in other words, except taxes; is that true?

A. That is correct.

Q. And I note particularly that this per cent of gross revenue is a generally decreasing line, is it not, from the high point at the year 1932?

A. Well, yes. It has shown a marked decrease over the years.

It looks like it is beginning to level out, but the February 28, 1942, figure was the lowest shown to that date.

* * * * * * * * *

[fol. 10108] Q. Will you turn, then, to the lower left hand subchart of chart No. 2 on Exhibit 253 and state what that shows?

A. In that section I show the taxes as a separate item, giving the full year 1941, and there I show three additional bars: one covering the pro forma 1941 figures, the actual for the year ended February 28, 1942, using, in both instances, the 1941 tax rates, and then in the last bar the figures for February 28, 1942, using the statement that was made by Secretary of the Treasury Mr. Morgenthau in his recent discussion of the proposed new tax bill.

Q. March 3, 1942?

A. March 3, 1942.

Q. Now, what is shown on the right-hand side subchart at the bottom of chart No. 2?

A. In that section is shown the net operating income after taxes, giving the same type of figures, namely the full year 1941 for Panhandle Eastern Pipe Line Company alone, then the pro forma as of December 31, 1941, the year ended February 28, 1942, based on the 1941 tax rates, and the year ended February 28, 1942, based upon the statement of the proposal by Secretary of the Treasury Mr. Morgenthau, and that shows that the influence of the tax would be equivalent to a reduction from approximately \$6,400,000 to \$4,500,000.

[fol. 10109] Q. Mr. Coffman, do the figures contained on all these subcharts of chart No. 2 come from Mr. Watkins' exhibits?

A. As stated on table supporting chart No. 2 they come from Mr. Watkins exhibits Nos. 173, 195, 198, and 199.

* * * * * * * * *

[fol. 10112] PAUL B. COFFMAN having been heretofore duly sworn, resumed the stand and was examined and testified as follows:

Direct Examination (Resumed)

By Mr. Wheat:

Q. Mr. Coffman, I believe at recess last evening you had completed your discussion of your Chart No. 2 in your Exhibit 253; is that correct?

A. Yes, sir.

Q. Now, will you turn to Chart No. 3 and briefly state what that chart shows.

A. Chart No. 3, in Exhibit 253, captioned "Percent Earned on Invested Capital of Panhandle, Based upon Net Gas Plant and Working Capital 1932-1941," is similar to Chart No. 11 in Exhibit 65.

In Chart No. 3 I have merely added the nine months figures for '32, the full year 1933, and the full year 1941. It shows in the left hand portion the invested capital and for the full year 1941, that was, in round figures, $62,200,000, which was an increase from the 1940 figure of $59,900,000 shown in Chart No. 11 on Exhibit 65.

[fol. 10113] In this exhibit the average which has been calculated now covers 9¾ years as against the shorter number of years covering 1934 to 1940, shown in Chart No. 11 in Exhibit 65.

The average invested capital for the 9¾ years was $53,300,000, in round figures, and invested capital here is defined as net working capital plus net gas plant.

Q. Well, note in two years you do not have any indication of working capital, that is, the years 1935 and 1937. Will you please explain that situation?

A. Well, those two years are marked in the exhibit and are explained by the fact that there was a deficit of net working capital in those two years.

Q. Now, in respect to operating income, what does the chart show?

A. Well, the chart covers the same period, 9¾ years, shows the net operating income in the bars, a 1941 figure of $5,541,000, in round figures, comparing with the $5,700,000 in 1940.

The average for the 9¾ years was $3,300,000, and the average return on invested capital was 6.14 percent for the nine and three-quarters years.

Q. I notice, Mr. Coffman, on Chart No. 11, Exhibit 65, that up to the close of 1940 was 7.11 percent, and that in Chart No. 3 of Exhibit 253, it is the figure you have just [fol. 10114] stated, namely 6.14 percent. Will you explain the reasons for that difference?

A. Well, it is explained by two facts in Chart No. 3 of Exhibit 253, a longer period considered and taking those figures into consideration, you get a different percent earned on invested capital.

Further than that, the Chart No. 11 in Exhibit 65 did not carry the 1941 figures, whereas this one does.

Q. I notice that the 1941 figure is below the 1940 figure. Will you state what that situation is and what was the cause of that particular decrease?

A. Well, that is just merely registering the increase in taxes taking place.

Q. A decline of something over 1 percent; is that true?

A. That is correct.

Q. Now, is it your view that that particular factor will be equally or increasingly operative in 1942?

A. I think the evidence points in that direction very definitely.

Q. Now, will you turn to Chart No. 4 and let me ask—

Mr. Littman: Pardon me, may I interrupt?

Mr. Wheat: Yes, any time.

Mr. Littman: May I ask whether the figures for the year 1941, reflected in Chart No. 3, are before the consolidation.

[fol. 10115] The Witness: Yes, those figures are before the consolidation. They are for Panhandle Eastern Pipe Line Company alone.

By Mr. Wheat:

Q. May I ask you whether uniformly through your Exhibit No. 253 you have shown items which do contain the consolidated figures with the notation "pro forma"?

A. Yes, they are shown. They are clearly marked when we come to them.

Mr. Wheat: I think that explanation should be made so we all know that where it is marked "pro forma" we will know that the consolidated figures are included.

Mr. Littman, I hope you will interrupt for any purpose such as this at any time. I think it saves time to do it and is a preferable method of handling the examination on a detailed matter such as this.

Mr. Littman: Thank you.

By Mr. Wheat:

Q. Now, will you turn to Chart No. 4, Mr. Coffman? I note that is also percent earned on invested capital of Panhandle Eastern, and I will ask you whether this chart contains information similar to that on Chart No. 3, except that it is based upon the capital structure rather than on book investment.

A. Yes, that is the only difference. It is similar cal- [fol. 10116] culations, but just using a different base upon which to make the calculation.

Q. Does it also contain identical data to that contained on Chart 10 on Exhibit 65, except for the addition of the years 1932 and 1933 and 1941?

A. Yes, that is correct.

Q. Now, on Chart No. 4, I note that the average operating income is $3,300,000, which, of course, is the same figure shown on the right-hand bar of Chart No. 3. I note also that the percentage average for the nine and three quarters years is 6.14, which apparently is the same percentage figure as that shown for percent earned on invested capital in the average in Chart No. 3, those two figures happen to come out exactly the same; is that correct?

A. That is correct. The average invested capital for the nine and three-quarters years regardless of whether you base it upon the capital structure or whether you base it upon the net working capital and net gas plant after reserves, gives you an average of $53,300,000 so that the two approximate each other, for there is no difference in the percent earned on invested capital.

Q. Now, I think we should now turn to your Chart No. 5 in Exhibit 253.

You there also added the periods at the outset and at the end, have you not, that you have mentioned in respect [fol. 10117] to the other charts?

A. Yes, sir, that is correct.

Q. So that you now have an average of nine and three-quarters years in all the subcharts of Chart No. 5? Is that correct?

A. That is correct.

Q. Now, will you please explain what is shown on Chart No. 5?

A. In Chart No. 5 of Exhibit 253, I show information similar to that contained in Chart No. 12 in Exhibit 65, with the exceptions you have just mentioned by way of addition on the nine months figures for 1932, full year of '33, and the full year of 1941.

Chart No. 5 of Exhibit 253 is divided into three parts. The first part shows the investment represented by common stock and surplus, and that indicates that the average for the nine and three-quarters years in round figures amounted to $22,300,000.

The second portion represents the dividend return to the common stockholders from the 1932—April, 1932—beginning to and through 1941, showing that the dividend return to common stockholders for the average of the nine and three-quarters years was $780,000.

The third section shows the percent return to common stockholders which is merely converting the dividend return [fol. 10118] actually received into the investment represented by the common stock and surplus showing that for the nine and three-quarters years on the average the common stockholder has had a return of 3.48 percent and that figure has the significance, as I think I pointed out in connection with Exhibit 65, that I believe that a common stockholder is perfectly willing to invest in a company and he is perfectly willing to bide time to get a return on the investment. But some place along the line he expects to receive enough return so that on the average he will receive what he believes to be a figure sufficient to com-

pensate him for the risk he took, and certainly 3.48 on this common stock wouldn't be considered sufficient.

Q. It wouldn't be sufficient to attract additional capital?

A. No, it wouldn't, unless the company could be permitted to earn money so that over the coming years dividends can be paid on the common stock which will tend to bring that average up to a higher level.

I think it is pretty obvious it would be rather difficult to expect new money on any common stock financing on any such percentage basis as that.

Q. You mean the lean years would have to be compensated for?

A. Yes, you have to make up for the period of waiting [fol. 10119] you have had in the period of bad years you have experienced.

Q. And in saying what you have, you are not referring only to this particular company, but to the general principle of the stock market?

A. I generalize on that point.

Q. Now, will you turn to your Chart No. 6 and state what is shown on that chart?

A. Chart No. 6 in Exhibit 253, captioned "Percent Earned on Invested Capital of Panhandle, Pro Forma for Twelve Months Ended February 28, 1942." This exhibit contains data which does take into consideration the property acquisition. As the title indicates, it is the pro forma, considers the consolidated company, and it shows the invested capital as of February 28, 1942, amounting to $78,477,214, defining here invested capital as the net gas plant which amounted to $71,900,471, and net working capital which amounted to $6,576,743.

In the next two bars I show the net operating income, the first figure of $6,361,247 taking into consideration or after the application of the 1941 tax rates. I show a second bar in the amount of $4,526,619, which is taking into consideration net operating income, but applying Mr. Morgenthau's proposal as of March 3, 1942, as to what the new 1942 tax may be.

Q. Well, you mean, do you not, that based on actual [fol. 10120] net operating income for 1941, should Mr. Morgenthau's proposal, or any approximating it, come to pass, the income on that basis would have been about $1,-800,000 less than it actually was?

A. That is right, if the 1942 Act, as he proposed it, were in effect, with the present earnings, instead of having $6,-361,247, you would have $4,526,619, or about a million eight hundred thousand dollars less, because of the increased taxes which are proposed.

Q. Now, as I recall it, Mr. Coffman, when you were discussing Exhibit No. 65 some months ago in these proceedings, you used an estimate of $1,000,000 1941 tax increase; is that correct?

A. Yes. In Chart No. 14 of Exhibit 65 I have a similar calculation.

Q. That was for Panhandle alone?

A. That was for Panhandle Eastern alone, as of the 12 months ended as of June 30, 1941, showing an operating income of $5,814,975, applying the 1940 rates, and then taking that same net operating income, but believing that the 1941 rates were then in force, would have shown that the net operating income would have dropped because of increased taxes to $4,811,075, or their one million dollar difference just by change in tax rate.

Q. Well, is the $1,800,000 you have mentioned in con-[fol. 10121] nection with the Morgenthau proposal in addition to that million dollars?

A. Well, for all practical purposes, it is; because we have just come down an additional year and the 1941 rates were applied and now taking the 1942 situation, it is additional taxes that the company would be forced to pay.

Q. What effect does that have on the percent earned on invested capital?

A. Well, on the present reported net operating income for the twelve months ended February, 28, 1942, the company would be showing an 8.41 percent earning on invested capital.

That is where the 1941 tax rate is applied, but it would only show 5.77 percent earned on invested capital if Mr. Morgenthau's proposal becomes an actuality.

Q. Well, that is based upon the assumption that the gross revenue would remain the same?

A. Well, that is just talking about the revenue for the 12 months ended February 28, 1942.

Q. Well, we will come to the question of amounts of revenue later, but let me ask you would those percentages be lower, were a lower base to be used, than the seventy eight million odd dollars which you show?

A. Well, it would depend on the change in figures. Any change in the two base figures, either the net operating income figure or the invested capital figure, necessarily [fol. 10122] will change your percentage, so whichever way the figures change, the percentages will—

Q. (Interposing) You used the 1941 in this chart?

A. Yes, that is correct.

* * * * * * * *

By Mr. Littman:

Q. Before you leave Chart No. 6, I want you to just refer to "actual 1941."

Mr. Wheat, did you mean that?

A. I was talking about the 1941 tax rate.

Mr. Wheat: Yes.

Mr. Littman: Tax rate?

The Witness: $6,361,247 is after application of the 1941 tax rate.

Mr. Wheat: Yes, that is what I think we both meant.

The Witness: Yes, actual figure.

By Mr. Littman:

Q. Mr. Coffman, I want to make certain, before you leave Chart No. 6, that your computation of "percent earned on invested capital" reflects a purported working capital in the amount of $6,576,743.

A. You mean there that the $6,576,743 was included in the invested capital?

[fol. 10123] Q. Yes.

A. Yes, that is correct.

Q. Now, Mr. Coffman, are the details of the calculations on the tax proposed by Mr. Morgenthau available?

A. I have some calculations that I come to later.
Q. In this Exhibit No. 255?
A. 253.

* * * * * * * *

Q. Might you give us the reference now? Could you do that for us while we are on the subject? I don't mean that you should elaborate on it. Just merely give us the reference to the exhibit which shows your calculations of taxes.

Mr. Wheat: In this connection, you took Mr. Watkins' figures, didn't you, Mr. Coffman?

The Witness: Yes, that is correct.

A. It starts on Exhibit 253 table supporting Chart No. 4. Page 2 and page 3.

By Mr. Wheat:
Q. That shows the calculations; is that correct?
A. That is correct.

Mr. Littman: Thank you.

By Mr. Wheat:
Q. Of course, that does not show the precise tax rates [fol. 10124] proposed by Mr. Morgenthau, does it? That matter is a matter of public information.
A. Well, I understood Mr. Littman to ask me what the procedure was I followed.
Q. Yes.
A. And I am merely showing him where the figures are. I do not have the newspaper release or a photostatic copy of it in which Mr. Morgenthau made his statements in the newspaper; but I have that reference.
Q. But on the tables supporting Chart No. 4, you do show the actual rates that were applied?
A. Yes, and the principle of calculation; that is correct.

* * * * * * * *

By Mr. Wheat:
Q. Now, Mr. Coffman, I want to be sure that everyone knows in connection with each of these charts in Exhibit 253 where there is any necessity for any basic data beyond

that shown in the charts themselves, it is shown on tables supporting the individual charts at the end of Exhibit 253, is it not?

A. Well, there is either a full statistical presentation in the tables at the end of Exhibit 253 supporting the charts as designated, or a summary table which would [fol. 10125] give the resume of facts and then reference is made to another exhibit for the detailed facts.

I mean, after all, I couldn't put all this business in one volume, so I put a summary in 253.

Q. When you referred to "this business," you meant Exhibit 254?

A. That is right. 254.

Q. All right.

Now, then, will you turn to your Chart No. 7 and state whether that is similar to Chart No. 6, except that it is upon the basis of invested capital represented by the capital structure of the company as against invested capital as represented by net gas plant plus net working capital, which is shown on Chart No. 6?

A. Yes, that is correct, and this chart No. 7 in Exhibit 253, captioned "Percent Earned on Invested Capital of Panhandle, Pro Forma for 12 Months Ended February 28, 1942," shows that the invested capital on this method of a calculation which is based on capital structure, totaled $77,830,553, and the information contained in here is similar to that contained in Chart No. 15 in Exhibit 65.

Q. Mr. Coffman, I note that the titles of both charts Nos. 7 and 7 were identical.

The important point to recall is that Chart No. 6 as shown at the bottom left-hand side is based on net property [fol. 10126] intangibles and working capital, and Chart No. 7 as shown at the bottom left-hand side of that chart is based on capital structure; is that not correct?

A. That is correct.

Q. The titles themselves do not show that difference, do they?

A. No, sir. That is right. They are both invested capital.

Q. Now, to return to your Chart No. 8, will you state what you have shown on that chart?

May I first preliminarily ask you whether a chart similar to this chart No. 8 was included in your Exhibit 65.

A. No, sir, there was not any.

Q. Why did you include it in Exhibit 253?

A. At the time of the last hearing there were several questions asked regarding the size of the working capital which I had included in the calculation to determine invested capital.

Q. You mean the items which you have labelled, through your exhibits, as net working capital; is that true?

A. That is correct.

Q. Cash on hand, in other words; is that right?

A. That is right.

Q. Proceed, please.

A. The figure as of June 30, 1941, as shown in Exhibit [fol. 10127] No. 65 amounted to $4,661,875.

Q. May I ask whether that is not the same figure shown on Chart No. 14 of Exhibit 65?

A. That is the same figure.

Q. Yes. As of the same date?

A. As of the same date.

Q. Now, what happened to that as time went on?

A. Well, between June 30, 1941, and December 31, 1941, there had been a drop of a little over a million dollars so that the net working capital figure, as of December 31, 1941, amounted to $3,507,683, and in the following two months, over to February 28, 1942, it had suffered further decline to $2,951,908 but in the course of the acquisition of the new companies and the refunding or the refinancing, a certain amount of capital to replenish the working capital was received, so that the total net working capital as of February 28, 1942, was $6,576,743. But against that were estimated plant expenditures carrying out through the ten months of this year to December 31, 1941, which was already budgeted and under way, amounting to $6,530,900, and I show that merely to indicate that although a particular figure of net working capital may be of certain size at one time, by itself it doesn't mean a great deal without further investigation as shown here clearly that if the net working capital of $6,576,743 is considered high, one must [fol. 10128] also consider the estimated plant expenditures

which will use up that working capital and will use it up in the next ten months.

* * * * * * * *

Q. In other words, all this cash will be used up and eaten away during the year 1942, won't it?

A. That is correct.

Q. Now, there will have to be some replenishment, won't there, in order to run this business?

A. Yes, the company can't continue as a going concern without having working capital day to day as it continues to operate.

Q. Where will it have to come from?

A. Well, it will come from earnings if the company continues to operate on a profitable basis.

Q. All right.

Now, explain how that can be accomplished.

A. Well, as the company continues to sell its service [fol. 10129] to the public, it receives revenue therefrom out of which the cash is built up and from that cash account are items paid out for expenses, salaries, wages, and so forth, and so long as the revenue flowing through cash account exceeds the amount of outgo, you have a balance in the cash account for working capital purposes.

Q. Well, the company has to pay interest, doesn't it?

A. Well, in addition to the regular operating expenses, there are several different corporate purposes that have to be taken care of: that is, the interest on the bonds and the preferred dividends, and if there is to be a dividend upon common stock, that will take a certain portion of cash and the cash has to be sufficiently large also to meet the sinking fund requirements when bonds and preferred stock must be purchased to meet the requirements as stated in those additional securities.

Q. It will have to pay additional taxes, won't it?

A. Yes, very definitely.

Q. Now, is there anything further you think ought to be said with respect to your chart No. 8 in explanation of it?

A. Well, I don't think there is. The one point that I think is significant: that some question was raised about

the size of the net working capital as of June 30, 1941, but as shown, that had dropped almost 50 percent in a matter [fol. 10130] of eight months, so that it indicates that there is this conversion process going on from week to week and month to month where working capital at one time, converted to other purposes at another time, so that there is a matter of how much you need.

Q. I think, Mr. Coffman, that you just mentioned in connection with Chart No. 8 the necessity for the company having earnings to cover sinking fund and maturity provisions for debt and preferred stock.

Now, will you turn to Chart No. 9 and state what is shown on that chart.

Mr. Littman: Before you turn from Chart No. 8, isn't there a typographical error in the table supporting Chart No. 8, Mr. Coffman? I refer to your caption where you use the term "Net Worth Capital."

The Witness: Yes, sir, Mr. Littman. It is "Net Working Capital."

* * * * * * * *

[fol. 10131] By Mr. Wheat:

Q. Now, will you proceed with your explanation of Chart No. 9, and state, first, whether it contains data of somewhat similar character to that which was contained on Chart No. 17 in Exhibit 65.

* * * * * * * *

A. The data contained in Chart No. 9 of Exhibit 253 is somewhat similar to the data contained in Chart No. 17 in Exhibit 65.

Q. What differences are there between these two charts?

A. Well, the principal difference is that in the Chart No. 17, Exhibit 65, there is there shown a schedule of the outstanding debt and the schedule of debt retirement, but in addition to that information on Chart No. 9 is also [fol. 10132] taken into consideration the preferred stock which new preferred stock being issued, carried sinking fund, and therefore the sinking fund provisions had to be taken into consideration, so this shows both preferred and bonds.

Q. Mr. Coffman, would this be a fair statement of the situation: that at the time you prepared Chart No. 17 of Exhibit 65 you had a certain long term debt with a certain sinking fund provision and that now, as reflected on Chart No. 9 of Exhibit 253, you have a larger long term debt or bond issue with a sinking fund and also you have a preferred stock with sinking fund provisions which did not exist at the time you testified before?

A. Yes, that is correct.

Q. What is the annual cost of those sinking funds?

A. Well, referring to table supporting Chart No. 9, in Exhibit 253, the detailed figures are given showing that as of March 1, 1942, the par amount outstanding at the beginning of the year was $33,250,000.

The retirements during the year will amount to one million and a half dollars. The cost of retirement $1,503,125, making the accumulated cost $1,503,125 when the sinking fund begins to operate and then it steps up as is shown in table supporting Chart No. 9.

Q. And also as shown on the right-hand subchart of your Chart No. 9; is that true?

[fol. 10133] A. Yes, except it is a little easier to pick those figures up from the table than it is from the chart to get the total, because the preferred stock also has a cost of retirement feature which must be included.

Q. Now, I notice that for the year 1942 that latter item is considerably less, also with respect to the bonds, than it is in the later years, down to 1961; is that correct?

A. Yes, the figures begin as of March 1, 1942, so that you do not have a full year there, in the first place, so that you get a total funded debt and preferred stock retirement cost in 1942 of $1,603,085, but then starting with January 1, 1943, that figure immediately goes to $2,307,500 and continues at about that same amount over until 1960, so that the annual amount really that has to be provided for sinking fund purposes is equivalent in round numbers to $2,300,000.

Q. In other words, I take it that this chart shows, as compared with Chart 17 of Exhibit 65, that under the new financing and because of these added sinking funds that you have mentioned, a greater cost was placed on the

company than is shown above, and that must be provided for?

A. Yes, there is a greater cost on the company and a larger amount has to be provided for.

This chart No. 17 on Exhibit 65, the annual amount was [fol. 10134] $1,250,000, whereas, as just discussed in table supporting Chart No. 9 in Exhibit 253, that cost will be $2,307,500 per annum.

Q. And will be two million and a quarter at least down to 1961, will it not?

A. Well, I have made a general statement there that it would be approximately that figure to 1961.

There are slight annual variations, but it is better than $2,200,000 through to 1960.

Q. Now, Mr. Coffman, will you now turn to your chart No. 10 in Exhibit 253. Let me ask you whether that chart is similar generally to a chart which was contained in your Exhibit No. 63, and I refer here to chart shown opposite page 23 of Exhibit 63.

A. Yes, that is generally correct. The information at the time of the last hearing which was submitted on investors' appraisal of over-all capital risk in various divisions of the utility industry for 1937-1940, was contained in two separate exhibits: Exhibit 63 in which opposite page 23 there is a chart showing similar information, and then in Exhibit 64 which supported 63, were given the detailed statistics from which the study was originally compiled.

[fol. 10135] Q. Now, how in general does your chart No. 10, Exhibit 253, differ from the previous data?

A. In Exhibits 63 and 64 I had data only for the years 1937 through 1940.

In chart No. 10 of exhibit 253 I have added the figures for the full year 1941, where they were available, and have calculated an average for a five-year period instead of an average for a four-year period, as was the case in exhibits 63 and 64.

Q. Let me ask you, Mr. Coffman, whether the addition of the 1941 data made any real change in the over-all re-

sult or relationships which were shown in the previous exhibits.

A. Well, generally speaking I don't think that the addition of the 1941 figure had changed the over-all figures materially.

For example, in the water companies I show a weighted average figure of investors' appraisal of over-all capital risks for the five-year period of 5.34 per cent.

Q. That is, contrasted with 5.38 per cent for the four-year period, is that true?

A. Yes, that is correct, and in contrast to the various figures which are shown for the individual years, 5.53, for instance, for 1937; 5.24 per cent for 1938, 5.64 for 1939, 5.13 for 1940, and 5.32 for 1941.

I think that is remaining remarkably close for a five- [fol. 10136] year period. I wouldn't say that there are any radical variations in it.

Q. I note that the data on the five-year period, with respect to electric operating utility companies, shows also a fairly close relationship over the years, does it not, in connection with investors' appraisal of your securities?

A. Well, it, I should say, could be described as remaining about as stable as any of the divisions shown here, and the weighted average for this five-year period shows 5.53—or you might call it 5½ per cent on the average.

Q. Well, that is as against 5.47 which you showed for the average of the four preceding years, is it not?

A. That compares with 5.47 per cent as a four-year average for 1937-1940, both inclusive.

Q. Now, what happened with respect to manufactured and mixed gas companies?

A. Manufactured and mixed gas companies showed a variation in 1941 that was higher than 1940. The '41 figure was 7.37 per cent as against 6.89 per cent for 1940, but the average for the five-year period was 6.94 per cent as compared with 6.61 per cent as shown in my exhibit 63.

Q. Now, what did the addition of the year 1941 do with respect to the data on all natural gas companies?

A. Well, on all natural gas companies the 1941 figure tended to reduce the average because the 1941 figure was [fol. 10137] somewhat lower. It amounted to 7.83 per cent

as compared with 8.03 per cent for 1940, and the average was then 7.82 per cent.

Q. Now, what about natural gas pipe line companies?

A. Well, natural gas pipe line companies, the drop is somewhat sharper than the one for all natural gas companies. The 1941 figure was 8.89 per cent compared with the 1940 figure of 9.55 per cent, and the weighted average was 9.19 per cent as compared with 9.38 per cent, the four year average as shown in exhibit 63.

Q. The weighted average, with respect to the natural gas pipe line companies, then was slightly below the arithmetic average of the four year period shown in exhibit 63, is that correct?

A. Yes, that is correct.

Q. In all instances in chart No. 10 of exhibit 253 have you weighted these averages?

A. In each case, in the data shown in chart No. 10 of exhibit 253, the data have been weighted, and by "weighting" I mean there giving the highest weight to the last figure, and so on back.

In other words, being a five year period, I have given the 1941 figure a weight of 5; 1940 figure a weight of 4; and so on back to 1937, which has a weight of 1.

In other words I have weighted the average according [fol. 10138] to the most recent information.

Mr. Littman: Is my understanding correct that the weighting feature was not used in your earlier exhibit No. 63?

The Witness: That is correct.

* * * * * * * *

The Witness: Yes, sir.

Mr. Lee: I don't quite understand your definition of weighting.

* * * * * * * *

The Witness: If you will refer to table supporting the chart No. 10 at the back of the volume you will see the statistics for each of the groups—water companies, electric operating utility companies, and so forth—for the five

divisions, and there I have given the rate for each year, and then have shown the weighting in reverse, namely that 1941 is given a weight of five, 1940 a weight of four, and so forth, and applied that to get the weighted average which is shown.

* * * * * * * * *

By Mr. Wheat:

Q. Now, Mr. Coffman, as shown in the note on the table supporting chart No. 10, the method which you used in selecting the companies and also working papers covering the data up to and including 1940, were actually [fol. 10139] included in your previous exhibits in this matter, 63 and 64, were they not?

A. Yes; that is correct.

Q. And also to working papers covering the 1941 period those data are included in exhibit 254: is that correct?

A. They are included in Section 4 of Exhibit 254.

Q. By the way, in connection with exhibit 254 each separate section is separately numbered by pages: is that correct?

A. Each section is consecutively numbered, and then a new section appears to start new numbering, and that goes on consecutively for just the section only.

Q. Now, is it a fact, in connection with the data shown on your chart No. 10 of exhibit 253, that the general relationships between the various types of utility services included, are shown to continue throughout the years in question?

A. Well, when I originally presented data of this sort at the last appearance I made, I said that I believed this information indicated that investors were demanding more by way of return in the natural gas pipe line companies than the other divisions of the utility field, and showed that there was the graduation in the amount required as shown now by the five-year average of 5.34 per cent for [fol. 10140] water companies, up through the various divisions to 9.19 per cent in natural gas pipe line companies, and I believe that investors are still doing what they have been doing for a great many years: drawing distinctions in risk, and as the risk goes up in their opinion,

the demand for a return on their capital must go up, and does go up.

In other words I think these figures here—it isn't what I think, really, or what anyone else thinks: it is what the man that put up a thousand dollars or a hundred thousand dollars, or is willing to do it, thinks about it, and that is what this figure represents: it is his opinion, and he is the man who is furnishing the capital.

Q. Well, is this chart based entirely on objective data?

A. Yes, all of it is based upon earnings shown by the companies and based upon quotations on their securities which is all objective data.

Q. I think you stated yesterday that, so far as you knew, there is no way to force investors to put up their money in companies of this sort.

A. No, there is no way; it is a matter of making an investment that is a security which you are trying to sell, sufficiently attractive among the great many possible selections, make it attractive enough to have people put their money in so that you can have the use of it.

[fol. 10141] Q. Mr. Coffman, you have used the words "over-all capital risks": I take it that includes both the fixed capital and common stock participations.

A. That includes bonds, preferred stocks, and common stocks.

Q. All those types of securities?

A. That is correct. And notes, if there were any. Any kind of borrowings that might have been made.

Q. Is there anything further that you think should be stated in respect to chart No. 10 at this time?

A. Well, I don't believe there is. I think I have covered the facts pretty well.

Q. All of the data on which you based your chart No. 10 is contained either in the tables in exhibit 253 or in the appendix in exhibit 254 or in exhibits 63 and 64 in this proceeding, is it not?

A. That is correct. If I can restate it: if a person wanted to examine now all the information I have presented on this subject it would be necessary for him to refer to exhibits 63 and 64 and exhibits 253 and 254.

Between those four exhibits are all the basic material and data that are represented here in graphic form.

Q. So that everyone who now has those exhibits in his hands has not only your conclusions, based upon that data, but has all of your working papers, so to speak?

[fol. 10142] A. That is exactly correct.

Q. Now, I wonder if you will turn to your chart No. 11 of exhibit 253, and first briefly state what that chart includes.

A. Well, chart No. 11 in Exhibit 253, captioned "Investors' appraisal of over-all capital risks, 153 stable industrial companies": I had in mind in such tabulation to make a study of industrial companies which could be considered by their record, particularly their continuance and regularity of [dividenc] payments, to be as stable as any industrial activity you could get, and therefore closely approximating stability that one would expect in a regulated industry, but I wanted to go out of the regulated field to see what the over-all capital risk, the investors' appraisal, was for that group of companies.

Q. Why did you select a certain group of companies?

A. In order to be sure that I was including all companies I based the data in chart No. 11 on all the securities listed and traded on the New York Stock Exchange over the past ten years.

Q. Let me ask you, right there: How many such securities have been traded on the New York Stock Exchange over the past ten years?

A. Well, there were approximately three thousand different issues.

[fol. 10143] Q. And how many are there traded on that exchange now?

A. Well, according to the last yearbook of the New York Stock Exchange the total is now 2405.

Q. I take it from what you have said, and from the fact that chart No. 11 contains data, according to its title, on 153 companies, that you must have eliminated some companies in arriving at the list which you studied as a basis for chart No. 11: is that correct?

A. That is correct.

Q. Well, will you state, briefly but carefully, for the record, just what you did and how you went about making any eliminations which you may have made?

A. Well, I was interested here in common stock, so I first eliminated all of the bonds, which totalled 1,173. I next eliminated all the preferred stocks, which totalled 398.

That left remaining 934 issues of common stock, but from that group I had to make certain further eliminations.

Q. Why?

A. I eliminated 207 companies which did not pay dividends in 1941.

The remainder of 637 companies were studied for the period January 1, 1932, to April 1, 1942, and from these I had to make certain eliminations.

Q. What were those?

[fol. 10144] A. First I eliminated all the companies that were not listed on the New York Stock Exchange for the entire ten-year period, and secondly I eliminated all companies which had not paid a dividend on common stock in each year of the ten years.

That gave me a remainder of 153 companies, all of which were listed for ten years, all of which paid a dividend on common stock in each of the ten years.

Q. They didn't pay the same dividend, probably, for each of those ten years?

A. No. When I say they paid a dividend, I am not saying that they paid the same dividend: I am saying that they paid a dividend on the stock in each year. That dividend varied from one year to another.

Q. Now, in your studies, after you had made these eliminations, did you develop the investors' appraisal of the over-all capital risks of those companies that were left for that period?

A. Yes. On the remaining 153 stable industrial companies I then made the calculations to determine the investors' appraisal of risk.

Q. Now, as a matter of fact have any of these 153 companies continuously paid dividends for more than ten years?

A. Well, I have got certain figures here. Some of [fol. 10145] them have been paying dividends for quite a period. Most if not all of the 153 stable industrial com-

panies paid common cash dividends for a number of years prior to 1932; while the time available did not permit a detailed study to ascertain all facts for earlier years, data published in the New York Stock Exchange Yearbook indicate that 74 of these 153 companies have paid common cash dividends consecutively for at least 25 years.

48 have paid such dividends for at least 35 years; 21 for at least 45 years, and 18 for at least 50 years.

One company—Pullman, Incorporated—paid cash dividends on its common stock in [ever] year since 1867: a period of 75 years.

Q. Now, the chart No. 11 in exhibit 253 is, in effect, a summary chart of your study, is it not?

A. Yes, that is correct.

Q. Now, where have you included the details which lie behind the summaries shown on chart No. 11?

A. Well, first in exhibit 253 there is a table supporting chart No. 11 which gives summary figures, and then to get the basic data or working papers for more detailed information reference has to be made to exhibit 254.

Q. What is included in that exhibit?

A. That exhibit, in section 1, contains a complete list of industrial companies whose common stocks were listed [fol. 10146] on the New York Stock Exchange from January 1, 1932, to April 1, 1942.

Q. Now, what page are you referring to now in exhibit 254?

A. I am referring to the first section heading which is just before page 1 of section 1.

Q. Now, will you turn to page 1 of section 1 of that exhibit and explain how you have shown that data?

A. Well, beginning on page 1 of section 1, which is captioned "Complete list of industrial companies whose common stocks were listed on the New York Stock Exchange from January 1, 1932, to April 1, 1942," I start there, in alphabetical order, to list the companies that are in the group, and I have shown there the companies which paid dividends each year 1932-1941, both inclusive, as marked with an X in the accompanying column.

Q. So that, by looking at the several pages—I think three of them—of section 1 of exhibit 254, one can de-

termine which companies paid common stock dividends in each year from 1932 to 1941 inclusive, and which companies, therefore, were included in your detailed study the summary of which is reflected in chart No. 11 on exhibit 253?

A. Yes. That is a correct statement.

Q. What detailed data have you included in exhibit [fol. 10147] 254 with respect to the companies which were studied?

A. Well, in section 2 of exhibit 254, captioned "Summary showing computation of investors' appraisal of the risk of capital represented by 153 stable industrial companies," starting on page 1 of section 2, the companies are listed again—that is, the 153 which were selected—and there I show for each of five years 1937 through 1941 the indicated market value of capital of these 153 companies individually, and then I show the earnings available for capital for each of the companies for each of the years 1937-1941.

Q. I notice that in some instances there are no figures shown in the columns under the heading 1941 on pages 1, 2, and 3, of section 2, exhibit 254: why is that?

A.—Yes, that is correct, and the reason for it is that the time we were producing this study was early in this year, and as we know annual reports for a number of companies are not available until perhaps in the second quarter or third quarter of the year, so that all annual reports for all these 153 companies were not available.

Q. You used what were available, did you?

A. I used what were available, and if you will refer to chart No. 11—

Q. (Interposing) Exhibit 253?

A. (Continuing)—of exhibit 253, you will see that the [fol. 10148] 1941 figure carries a star, which explains that that figure is based on 119 companies for which 1941 annual reports were available prior to April 1, 1942.

Q. In other words you used every company that you could get 1941 data on out of this group of 153 companies, up to April 1, 1942?

A. That is correct.

Q. This being April 17, 1942?

A. This study for the 153 companies is as all-inclusive as we could make it at the time.

Q. Well, as a matter of fact, even for 1941 the total indicated market value of capital was over 14½ billion dollars, was it not?

A. Yes, the amount involved here in indicated market value is tremendous for most of the years—that is, 1937 through 1940, anyway.

The average would be something in excess of 20 billion dollars, which is a very substantial representation.

Q. Well, that is almost as much—or is as much, isn't it—as the entire national debt prior to the most recent period of increase in that debt?

A. Yes; that would be approximately correct.

Q. In other words you have adopted a very broad base for this study; is that not true?

A. That is correct, both as to the method of selecting [fol. 10149] the companies and as to their dollar value.

Q. Would you say that, in selecting these companies, you used objective data solely after you had determined that you were going to use only companies which paid a dividend in each of the last ten years?

A. What I am doing here is showing exactly what the investor is saying about these securities.

In other words, to get at the over-all investors' appraisal of risk, as I have explained, I used the earnings available for capital, and I used the indicated market value of capital, which is gained from quotations, and those two figures are certainly objective.

I had nothing to do with them except list them and tabulate percentages thereon.

Q. Now, in adopting that period of ten years during which these companies paid common stock dividends in each year, do you believe that you used some abnormal period?

A. Well, as I look upon the five-year period, as indicated by the figures, I think generally throughout there isn't anything especially peculiar about the period.

Q. As a matter of fact, the ratios that you found run fairly close together, do they not?

A. Yes. That was particularly true, it seems to me, of the figures shown on chart No. 10. There are no striking changes there at all.

[fol. 10150] Q. Well, you used the same period, didn't you, here?

A. Same period 1937-1941.

* * * * * * * *

[fol. 10151] Q. Mr. Coffman, I think at the time the recess was called, we were discussing the companies which you have used in your study contained in Exhibit No. 254 and summarized on Chart 11 of Exhibit No. 253. Let me ask you to explain in some detail what you had in mind in connection with the various eliminations which you have already described as having been made by you from the total list of companies whose securities were traded on the New York Stock Exchange?

A. My purpose was to start with some recognized source and, since the New York Stock Exchange is the leading stock market in the country and taking into consideration the time factor, I took all the securities listed on that Exchange solely. If I had had more time, I would have liked to have included the tradings on the New York Curb Exchange, but time would not permit but, nevertheless, since everyone is acquainted with the securities that are listed and traded on the New York Stock Exchange, I believe that to be a well known and recognized source.

Q. And you had some 3,000 companies, did you, to start with?

A. Some 3,000 companies.

Q. You consider that a sufficient base for such a study as you have made, did you?

A. Not only do I think it is a sufficient base but I think it is probably the most reliable and best recognized base [fol. 10152] because, after all, the New York Stock Exchange has been in existence for many years and they have had some rather definite rules and restrictions as to what companies could be listed and traded so that every company did not get on that Exchange to begin with. I mean they really performed quite an elaborate elimination long before this list that I am talking about was made. They automatically eliminated what they considered to be poor companies or unreliable companies or companies that could not qualify for listing and trading privileges on that Exchange.

Q. Now, you have told us what your eliminations were and given us the number of companies eliminated. Will you go ahead and discuss, briefly, the reasons behind those eliminations?

A. I was principally interested in the common stock phase because the common stocks in any company are the ones which depend for their return on the type of risk involved. In other words, their bonds carry very definite stipulations as to interest, sinking funds and so forth so that if any company should, some place along the line, run into difficulty, presumably the bond holders are the best protected of the various security holders of securities in a particular corporation.

Next in line are the preferred stockholders who are fairly well protected. The common stockholder, on the other hand, [fol. 10153] has to take the luck of the corporation in facing the risks and, if the earnings are sufficient to pay all the operating expenses, all the interest on the bonds, the dividends on the preferred stock and there is something over, then the common stockholder will get his return to the extent that the management feels they can declare dividends upon such stock so, in the last analysis, the real test in this matter was to see, in the companies that are listed here that paid dividends throughout the years, just how stable they were and they were the most stable in the group, what the investors said the risk was as measured by this investors' appraisal of risks.

Q. When you made the computation of the investors' appraisal of risks of capital on each of these companies, just what did you do? Where is that computation shown in your Exhibit No. 254?

A. Well, you will first find in section II the material that I have already recited, namely, the indicated market value of capital for each of the 153 companies except in those instances where the 1941 material was not available up to April 1, 1941, and I show earnings available for capital with the exception mentioned for the years 1937 through 1941.

In section III of Exhibit No. 254, I present the details of the calculations. For example, on page 1, of section III, information is presented in regard to Abraham & Straus,

[fol. 10154] Inc., in which I show the market value, that is, the indicated market value for the various types of capital outstanding as of January 31 for the years 1937, 1938, 1939 and 1940. I show for each of those years the price range for the year and each of the years the high, low and average. I used the average of the high and low in each year as the figure to multiply against the type of capital outstanding—

Q. (Interposing) That is what you did in connection with all your other studies of investors' appraisals, did you not?

A. That is correct.

Q. Go ahead.

A. Now, in the case of Abraham & Straus there is no figure for the year 1941 and that was first clearly indicated in section II, page 1, where it is shown that the Annual Report was not yet available at the date of study so there will be no 1941 figure but, if you take the second company which is shown on page 2 of section III, the Adams Millis Corporation, on page 2, I think the detailed information for the years 1937, '38, '39 and '40 and, on page 3 of section III, I show the same information for the year 1941 so that, if one goes through section III of Exhibit No. 254, you will find always on the first page, covering the company, the figures for 1937, '38, '39 and '40 and if the 1941 figure is available, it is always contained on the second page.

[fol. 10155] Q. Or the page following?

A. The next page following. These pages are numbered consecutively.

Q. Now, there are, I note, 275 pages in section III, is that correct?

A. Yes, that is correct. There are 275 pages in section III of Exhibit No. 254.

Q. Now, is it a fact that section III contains the data by individual years, as you have just described, for all of the corporations which are listed in section II of Exhibit No. 254?

A. That is correct. It contains all the companies listed in section II and that section has three pages.

Q. And is it also a fact that section II and the companies listed in section III are the companies which are

denoted by an "X" in the list of 470 corporations contained in section I of Exhibit No. 254?

A. That is correct or, to state it differently, it contains the companies whose figures are shown graphically on Chart No. 11 in Exhibit No. 253.

Q. And without going through section III, is it your view that anyone who might so desire can determine how you arrived at the figures you used as the basis for your Chart No. 11, Exhibit No. 253, by consideration of these detailed data in Exhibit No. 254?

[fol. 10156] A. That is correct with perhaps the additional statement that there is contained in Exhibit No. 63, in pages 5 through 8, a general statement of method which I used for Exhibits Nos. 63 and 64 which is exactly the same procedure except in connection with industrial companies for which data are supplied in Exhibit No. 254.

Mr. Littman: Mr. Coffman, can you advise whether your list of 153 "Stable industrial companies" includes all of the 30 Dow Jones Industrials?

The Witness: I do not think it does because I do not think that some of those stocks paid dividends throughout this period but that will be an easy matter to ascertain.

Mr. Littman: I thought perhaps you could tell us offhand.

The Witness: I think my answer is correct to say I am sure it does not but I can check it and get the list so there will be proof of it.

* * * * * * * *

By Mr. Wheat:

Q. I think you have explained why you selected these corporations and why you denoted them as stable industrial companies in connection with the study of the return which you have here made in this proceeding. Now, will you turn to section III of Exhibit No. 254 and state for [fol. 10157] the record what you have included in section III of that exhibit?

A. Section III or section IV?

Q. I am sorry, section IV is the one I meant.

A. In section IV of Exhibit No. 254 which section contains 51 pages, I have presented the working papers show

ing the computation of the investors' appraisal of the risks of capital in the natural gas industry as compared with other divisions of the utility industry for the full year 1941. Such data for water companies begin on page 1; for electric operating utility companies, it begins on page 9; for manufactured and mixed gas companies, it begins on page 25 and natural gas companies on page 36.

Q. Now, all of section IV of Exhibit No. 254—

A. (Interposing) That takes care of section IV of Exhibit No. 254.

Now, supplemental data for the years 1937, '38, '39 and '40—

Q. (Interposing) You mean this is supplemental to that?

A. This is supplemental to that, which data has already been shown in Exhibits 63 and 64 which are already in the record.

Q. So that by consideration of the data in Exhibits 63 and 64 and the data included in this section IV of Exhibit No. 254, all of the basic data underlying the supplementary Chart No. 10 of Exhibit No. 253 can be found?

A. That is correct.

[fol. 10158] Mr. Littman: Mr. Coffman, where is the underlying data for the natural gas pipe line companies shown in Chart No. 10 of Exhibit No. 253?

Mr. Wheat: I think if you will look at page 37 of section IV, you will find those companies listed. Also I think you will find separate sheets for each of those natural gas corporations in the sheets which follow page 37. In other words, they are grouped together there, Mr. Littman.

Is that not correct, Mr. Coffman?

The Witness: Yes, that is correct. Page 37—

Mr. Littman: (Interposing) The reason I inquire is because your caption sheet for section IV has a title that it includes natural gas companies but does not have a separate reference to natural gas pipe line companies.

The Witness: That is correct. I think that was an error. It might well have been put in although the natural gas

companies were put in at page 36 and there should have been included—

Mr. Wheat: (Interposing) You mean you made a separate page 37 listing them alone?

The Witness: That is correct but such page is not listed on the opening page for section IV but might well have been listed there.

By Mr. Wheat:

Q. As a matter of fact, Mr. Coffman, if you take the [fol. 10159] companies listed on page 37, you will find data upon them in the proper alphabetical place among the other natural gas companies for which data is shown on subseqrent pages of section IV, is that not true?

A. Yes, that is correct.

Q. So that all the data is here, is it not?

A. All the data is here.

Q. Now, Mr. Coffman, is there anything further that you wish to state in explanation of your Chart No. 11 in Exhibit No. 253?

A. Well, the same statement applies to Chart No. 11 in Exhibit No. 253 that was made to Chart No. 10 of the same exhibit, namely, that the figures shown therein are the investors' appraisal of the over-all risks of capital and these again are objective data. It is not an opinion that I hold. It is merely finding out what investors today are saying in regard to securities and a particular group of securities and, following the processes of elimination which I did to arrive at the 153 companies, I think probably that is as complete a tabulation as was ever made covering a ten-year period with detailed figures showing companies that have paid dividends each year in that ten-year period and I thought that that was a pretty good measurement of industrial stability, any company that could qualify in that list, taking the list as a composite, was a pretty good indication and it would seem to me [fol. 10160] would prescribe a minimum, so far as average is concerned, of 6.97 or call it 7 per cent in round figures which could be described as what investors are demanding in the most stable industries on the average.

Now, if you will break down the average to the individual years, it is obvious, in Chart No. 11, that the figures varied.

The figure for 1937 was 6.38 per cent; in 1938, it was 5.21 per cent; in 1939, it was 6.25 per cent; in 1940, it was 7.14 per cent and, for 1941, it was 7.99 per cent or, call it in round figures, 8 per cent. Now, the 1941 figure, as I have explained, covers only 119 companies, those being the only ones who had issued their annual reports up to April 1 of 1942.

Q. You have already stated also that does include market value of capital of a total of over 14½ billion dollars, does it not?

A. Yes, it does.

Q. That is about a cent higher than your weighted average, 8 against 7?

A. That is correct.

Q. There has been a marked and noticeable increase in investors' appraisal of risks of capital of these companies over the past four of the last five years, is that true?

A. That is correct. The figure has risen from 5.21 per cent in 1938 to a round figure of 8 per cent in 1941.

* * * * * * * *

[fol. 10162] By Mr. Wheat:

Q. I think you stated that your weighted average of investors' appraisal of risks of capital for these 153 stable industrial companies shown on Chart 11 of Exhibit 253 was 6.97 and I believe you stated you would round that out to 7 per cent. Is that correct?

A. That is correct. I said that would indicate a round figure of 7 per cent.

* * * * * * * *

[fol. 10163] Q. Will you turn to your Chart No. 12 headed, "Panhandle Eastern Pipe Line Company Invested Capital as of February 28, 1942," and state what that chart shows and also state its relationship to Chart No. 24 in Exhibit 65.

A. In Chart No. 12 of Exhibit No. 253, I have shown calculations similar to those presented in Chart No. 24 of Exhibit No. 65 but, in the case of Chart 12 of Exhibit No. 253, the figures there are based upon the condition of the company as of February 28, 1942, which takes in the

acquisition of the properties or, to state it differently, considers the consolidated company.

Q. And the new financing?

A. And the new financing, whereas the figures that were shown in Chart 24 of Exhibit No. 65 related only to Panhandle Eastern Pipe Line Company.

Now, in Chart No. 12, a comparison is made between the book value on the one hand and the market value on the other and it shows that as of February 28, 1942, the total invested capital, book value, was $77,830.535.

Q. I note, Mr. Coffman, in that connection where you have a column headed, "Per Cent of Total", that there has been some considerable change in the percentage of the total represented by common stock and surplus. Will you state what that change was and whether you believe it to be significant?

* * * * * * * *

[fol. 10164] The Witness: You are now making the comparison of the data in Chart No. 12 of Exhibit No. 253 with Chart No. 24 of Exhibit No. 65?

Q. Yes, that is exactly what I had in mind.

A. The changes represent, for the most part, those that were created by the recent financing put out by the company in connection with the new property acquisitions and the figure for common stock and surplus, as of February 28, 1942, for the consolidated company or its present status, was 36.71 per cent of total invested capital whereas the common stock and surplus at book value as of June 30, 1941, for Panhandle Eastern Pipe Line Company alone was 47.63 per cent of the total book value as of June 30, 1941, and the reason for those changes in the percentages is chiefly attributable to the issue of additional bonds and preferred stock in the recent financing which necessarily made changes in the capital structure and the book value thereof and, therefore, changed the percentages.

Mr. Littman: Was the 47 per cent you gave, Mr. Coffman, as of June 30, 1941?

The Witness: The figure of 47.63 per cent is based upon the balance sheet figures as of June 30, 1941, and, [fol. 10165] therefore, applies to book values as of that date.

Mr. Littman: I thought it might be well to note at this point that, in the Securities and Exchange Commission's opinion which is in evidence as Exhibit No. 147, page 17 shows the ratio to be, as of September 30, 1941, 43.62 per cent. It has, however, been called to my attention that the figure which I read is a consolidated figure and, therefore, would not be strictly comparable.

The Witness: That is correct.

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By Mr. Wheat:

Q. I think, Mr. Coffman, you also a few moments ago were about to make some comparison between the book value and market value figures as shown on Chart 12 of Exhibit No. 253. Is that correct?

A. Yes, that is correct.

In Chart No. 12 in Exhibit No. 253, the market value of that total invested capital was $73,328,771 and that figure, which is on the consolidated basis, has no counterpart in Chart No. 24 of Exhibit No. 65 so there is no comparison that can be made but it is of interest to see that the figure of $73,328,771 on the consolidated basis at market value compares with the $77,830,535 on book value on a consolidated basis as of the same time.

In the case of Chart No. 24 in Exhibit 65, the market [fol. 10166] value of the total invested capital on June 30, 1941, was $64,219,240, compared with book value at the same time for the same invested capital of $61,423,853.

Now; in Chart No. 12, there are one or two other items that I think have some significance.

Mr. Lee: Mr. Coffman, right on that, if you will pardon me for asking you, right on that last statement you made a comparison between the book and the market value, didn't you?

The Witness: Yes.

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Mr. Lee: If the book value of $77,830,535 is so greatly in excess of the market value, $73,328,771, the excess being accounted for, as I understand it, by, in part at least, the earned surplus on the books, if that earned surplus exists why isn't that factor reflected in the larger market value?

The Witness: Well, I think that there are several answers that can be given to the question.

In the first place, I think one must distinguish between an earned surplus item which is already accumulated and on the books as one measuring standard and the earning capacity of the company or its ability to continue its same rate or thereabouts of earnings that it has in the past as another standard.

[fol. 10167] Now, I think the market usually gives more weight to earning capacity than the market has given to book values at any time and the reason for that is that you can conceive of a situation at which, at a given moment of time, a company could show a very good book value with earned surplus and yet be in a dilemma where its business was going to be wiped out with no earning capacity. The minute that was known or believed by investors, prices would begin to go off, naturally.

Mr. Lee: Has that earned surplus shown on Chart No. 12 been distributed?

The Witness: No, it is a part of book value. As long as it is there, it naturally has not been distributed.

Mr. Littman: Mr. Coffman, may I interrupt to ask whether, in this illustration which you just gave, it is the fact that the earnings-price ratio would be high, very high?

The Witness: Well, I will answer it this way: That, as you get into a situation of that kind so that the prices go off more rapidly than earnings, your price ratio will tend to increase but, if the earnings were off too and if they both went off in the same proportion, they would not be relatively high.

Mr. Littman: Well, in your illustration, the earnings-price ratio would be very high.

The Witness: If I took it at that given moment of time, at twelve midnight of December 31 of whatever year, [fol. 10168] it was and the earnings in the particular year had been good or all prior years but, as of that time—just like, for instance, Prohibition. The Act goes in and earnings go out—it would be high at that point but only at that time. In making a study as I have done over a period of years, that would have no significance. It would be washed out.

Mr. Littman: In such event, the earnings-price ratio would be enormous, wouldn't it?

The Witness: It would depend upon the relationship, Mr. Littman. I mean, if you had zero earnings and a price, you have no ratio.

Mr. Wheat: As a matter of fact, it might go to infinity under those circumstances, might it not?

The Witness: As a matter of fact, it would go to a point where you could not calculate the ratio because, if you had no earnings, you could not even calculate it.

Mr. Wheat: Of course no such situation at present, in connection with the studies you have made of earnings-price ratio, is here?

The Witness: No. I was just trying to make clear the answer I was trying to give in regard to the question.

Mr. Wheat: I see.

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[fol. 10169] By Mr. Wheat:

Q. We all realize, don't we, Mr. Coffman, that individual days, with respect to individual companies, may create abnormal relationships?

A. That is correct but, so far as my study is concerned, all such companies with those particular items have practically been eliminated by one process or another. I mean, when you take a five-year period or a ten-year period obviously a thing that happens on one given moment of time has no significance.

Q. Now, is there anything further you think should be stated with respect to your Chart No. 12 in Exhibit No. 253?

A. Well, there is one further point that I think stands out clearly in Chart No. 12 of Exhibit No. 253. At February 28, 1942, on the consolidated basis at market value, the total debt was 45.70 per cent of the total invested capital at market value. The total preferred stock was 21.82 per cent and the common stock and surplus was 32.48 per cent of the total invested capital at market value.

Now, that shows that the common stock and surplus or equity capital, so-called, is getting down to a fairly low percentage in comparison to total capital and I think that there was some discussion of that at the time we went through Exhibit No. 65 several months ago. If you com- [fol. 10170] pare the new figures on the consolidated basis at market value with the situation on the Panhandle Eastern Pipe Line Company June 30, 1941, at market value, the total debt now of 45.70 per cent compares with a total debt of 36.59 per cent.

Q. At that time?

A. At that time for Panhandle Eastern Pipe Line Company alone and the preferred stock now has 21.82 per cent of total invested capital at market value as against 17.52 per cent as of June 30, 1941, for Panhandle Eastern and the common stock and surplus, or the equity, was then 45.89 per cent as against this 32.48 per cent.

Q. At the present time?

A. At the present time. Now, of course, I admit there has been the property acquisitions in between and you have the consolidated company as against just Panhandle Eastern as of June 30, 1941, but regardless of that fact, the present situation of capital now, it seems to me, is such so that the equity portion is to about as low a per cent as one should think it might go.

There is one further fact and that is that, in the new preferred stock that was issued, the preferred stock carries sinking fund provisions and is entirely different than the preferred stock that was outstanding in the old setup and there is, I think, some reason for saying this new preferred stock is more in the nature of a debenture or

[fol. 10171] part of the debt than it is in a straight preferred classification.

Mr. Lee: Isn't that a benefit to the common stockholders of Panhandle because of the unusual voting rights that some of the preferred stock had heretofore in Panhandle?

The Witness: Well, in describing advantages, I do not know because there are several ways to look at it.

For example, if you have added to the debt which has brought on additional sinking fund provisions which must be met year by year and, in addition, now you have brought out preferred stock which also carries sinking fund provisions, this matter, for example, of having to meet every year, according to these debentures, $2,300,000 in order to buy these securities for sinking fund purposes as against the earlier arrangement of $1,250,000, on that score I think there is some question. There is an additional load there.

On the other hand, the old preferred stock was a participating preferred. It is not now a participating preferred so at least whatever earnings come over available for equity are entirely available for equity.

Mr. Lee: And over and above all of that, so far as the common stockholder is concerned, since the acquisition of or the consolidation of the two companies, hasn't he been very fortunate to be able to acquire 100 per cent ownership of Michigan Gas Transmission by moneys furnished by the public and at a price lesser than the market price of [fol. 10172] Michigan Gas Transmission? Hasn't that been of great benefit to the common stockholder of Panhandle?

The Witness: There again there are two ways to look at it. It seems to me the pragmatic test on the thing is what the investor says about it. The investor says, as I interpret it, from looking at the quotations on the common stock, that he does not see any great benefit for the moment because, as of June 30, 1941, the common stock was then quoted at $36.50 and, as of February 28, after all this business had been consummated, it was $29.50. There has been a drop of $7.00 per share so far as market quotations are concerned.

Mr. Lee: Isn't that due to other causes?

The Witness: I cannot say that it may be due to other causes. There may be a number of causes that have a bearing on this and no doubt there are but even so, the investor is saying to this company that, so far as he is concerned, even after the consolidation and all the benefits and everything else, $29.50 is all he can see and that is all he is going to pay for a share of common stock so that, to me, is the significant thing. It makes no difference, as I have said, what I think about it. If the investor out here, who has got $1,000 or $200,000 to invest says the stock is worth $29.50, he is the fellow we have got to talk about. It isn't what I think about it or anybody else thinks about it, [fol. 10173] it is the investor.

Mr. Littman: You do not mean to infer this was a bad piece of financing, as far as the common stockholder was concerned, do you?

Mr. Lee: That is what I meant.

The Witness: I do not see there is any inference in that. All I said was as of February 28, 1942, because of an issue of preferred stock and because of more bonds, the percentages now of these various phases of capital have changed quite materially and that the equity capital, it seems to me, [it] getting down to a fairly low per cent. I mean [some-] like 30 percent out of the total capital is not in line with what the people in S. E. C. have been talking about when they have used ideal [radios] in looking at funded debt on the one hand and equity capital on the other.

Mr. Littman: Of course, S. E. C. approved this particular financing.

The Witness: That is correct but I believe they made some comment about the fact that they felt that the equity here was getting a little on the low side.

Mr. Littman: Where did they make comment on that?

The Witness: I think I remember seeing that, Mr. Littman. I will check it and see. I think there was some statement in the S.E.C. release to the effect that they

thought that the equity capital was somewhat low. I may [fol. 10174] be wrong but I will check it.

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Mr. Wheat: Regardless of that, the facts are shown on Chart No. 12 of Exhibit No. 253, are they not?

The Witness: That is absolutely correct.

Mr. Wheat: That is not your opinion or the S.E.C.'s opinion or anybody else's opinion except the investors'?

The Witness: That is right.

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[fol. 10189] By Mr. Wheat:

Q. Mr. Coffman, will you turn to Chart No. 13 of Exhibit No. 253, please?

A. Mr. Wheat, before we proceed, do you want me to answer the question that Mr. Littman left with me?

Q. Yes, I think that would be a good idea. State first what the question was so we will have it before us.

A. Before the noon recess, I had made some comment by way of answer regarding the sentiment of the Securities and Exchange Commission regarding the capital structure of Panhandle Eastern Pipe Line Company as it now exists under the consolidated condition and it was my recollection that the Securities and Exchange Commission had made some comment which would indicate that perhaps the equity of this company was approaching the minimum and Mr. Littman asked me just where, in the Securities and Exchange Commission's release, that was and in Exhibit No. 147.

My statement was predicated upon the statement made in the conclusions on page 23, the second full paragraph which I quote:

"Since the company is engaged in the business of the production and transmission of natural gas and hence is dependent upon a wasting asset, an all common-stock structure would seem to be preferable to that here contemplated. In view of the fact, however, that the ratios of [fol. 10190] debt and of debt and preferred stock to property are within reasonable limits and of the fact that

the sinking fund provisions with respect to both the bonds and the new preferred stock of the company should, if earnings are adequate, result in the retirement of all such senior securities prior to the prospective exhaustion of its gas reserves, we deem it proper not to impose any term or condition with respect thereto."

My comment that the equity under the consolidated situation was perhaps as low as it could go and my recollection that the Securities and Exchange Commission had believed that a larger proportion would be wise, came from the statement I have just quoted and particularly the first sentence where they say that—

"an all common-stock structure would seem to be preferable to that here contemplated."

Mr. Littman: You do not agree with the first sentence of that paragraph which you just read from the Securities and Exchange Commission's opinion, do you?

The Witness: In regard to the first sentence, you mean, "Since the company is engaged in the business of the production and transmission of natural gas and hence is dependent upon a wasting asset,—"?

Mr. Littman: That is right. And continuing—"an all common-stock structure would seem to be preferable to [fol. 10191] that here contemplated."

You do not agree with that, do you?

The Witness: I believe that it would be wise for this company to build up its equity position, very definitely. Whether or not it has to have an all common stock seems to me to not be too important.

What I am principally interested in is that a 32 per cent equity in a company engaged in this business seems to me to be approaching the lowest possible point for equity and the equity really should be built up rather than reduced.

Mr. Littman: Can you state yes or no whether you agree or do not agree with that sentence of the Commission's opinion?

The Witness: I should say that in any company dealing in a wasting asset, if they can finance the entire business by common stock, I would think that was preferable.

Mr. Littman: You do not think they can, do you, or should, do you?

The Witness: I do not know that I said anything to that effect any place in the record.

Mr. Littman: Look at your Chart No. 28, Exhibit No. 65, where you show your so-called ideal capital structure of 40 per cent of debt and 60 per cent of common stock.

The Witness: Well, you say [—] me "ideal capital structure." As a matter of fact, those ratios were based upon the ideal ratios that the Securities and Exchange Com- [fol. 10192] mission has been talking about and they have said, I believe repeatedly, a 40 per cent bond and 60 per cent common stock is within reason.

Now, if you can go beyond that and finance it, that is perfectly all right. My whole contention and belief in this evidence that I have submitted is that the common stock and surplus has been reduced to about as low a point as is consistent with the condition of this company.

Mr. Littman: Well, it appears that the Securities and Exchange Commission has said that the ideal capital structure for a natural gas company is an all common stock structure rather than the so-called ideal capital structure shown in your Chart No. 28. Is that correct?

The Witness: I do not think we are talking about the same thing at all, Mr. Littman. You have to start out with what is and what is [is] shown exactly in the chart that I presented in Exhibit No. 253. With the situation what it is, I do not see how it could be possible at the moment to change the capital structure to all common stock. That usually is not done. What you do is try to correct the situation as time permits and conditions enable you to do it and, therefore, I would say if you could work from what is to more in line with 40 per cent and 60 per cent, you would be working certainly in the right direction and if you could go beyond that finally to all common stock, as this company will be if the sinking funds work out and [fol. 10193] so on, for all practical purposes your trend is in exactly the right direction and I say no more.

* * * * * * * *

By Mr. Wheat:

Q. Now, Mr. Coffman, will you turn to Chart No. 13 and state what is shown on that chart?

A. Chart No. 13 in Exhibit No. 253 captioned, "Cost of Financing Panhandle Eastern Pipe Line Company 1st Lien and 1st Mortgage Series 'C', Sinking Fund 3's due January 1, 1962 (offered to public on February 3, 1942)" shows a price to the public of $100.75; shows underwriting commissions of 73 cents, expenses of 60 cents, leaving $99.42 as the net price received by the company. The new Series "C" bonds carried sinking fund provisions and, therefore, had retirement prices and the retirement price graduates downward through the years to maturity from [fol. 10194] $101.25 to $100 at the last call date.

Q. Now, what do you mean by your column colored red at the right-hand side of Chart 13 in Exhibit No. 253 which you have headed, "Adjusted Yield Weight Giving Effect to Sinking Fund Requirements"?

A. It is obvious as the company issued these bonds and the bonds had sinking fund requirements and would have to be called at some price in excess of the original price or carried a premium, that that premium cost must be included with the other cost of financing. I have merely taken into consideration those sinking fund premiums and made the calculation as to what the over-all cost is on an average and that is 3.13 per cent.

Q. Now, is there anything further you want to state about Chart 13?

A. There is merely the one further remark that Chart No. 13 is supported with full details by the table supporting Chart No. 13 at the end of Exhibit No. 253 where the figures are shown and the calculations.

Q. This is purely a mathematical deduction, is it not?

A. That is right. It is purely arithmetic.

Q. Will you turn to Chart 14 of Exhibit 253 and state if that is the same as Chart No. 16 in Exhibit No. 65, except for the addition of the years 1941 and 1942?

A. Chart No. 14 captioned, "Historical Costs of Debt [fol. 10195] Capital of Panhandle Eastern Pipe Line Company—1930-1942" in Exhibit No. 253 contains similar matter to that presented in Chart No. 16 in Exhibit No. 65 with the exception of the additional material that has been presented.

Q. What is that additional material?

A. It shows the figures for the full year 1941, shows the situation as it existed in 1942, February 28, 1942, taking into consideration the consolidated facts.

Q. And the weighted average at the right-hand side is 4.85 per cent instead of 5.17 per cent, is that true?

A. Yes, that is correct and the weighting procedure is exactly the same here as I have described before. It is giving the most recent figure the greatest weight.

* * * * * * * *

By Mr. Wheat:

Q. Now, turning to Chart No. 15, Exhibit No. 253, that deals with the preferred stock of the company, does it not?

A. Yes, it does.

Q. Will you state what is shown on that chart?

A. On chart No. 15 in Exhibit No. 253 captioned, "Cost of Financing Panhandle Eastern Pipe Line Company 5.6 Per Cent Preferred Stock Offered to Public on February 3, 1942", I show the price to the public of $104 per share; [fol. 10196] the underwriting commission which amounted to $3.72; the expenses, amounting to 60 cents, and the net price received by Panhandle of $99.68. I show also, since this is a sinking fund preferred stock, the retirement price of $105.

The total price, that is, the cost including the sinking fund costs, shows the rate to be 5.86 per cent based on the net price received by Panhandle. In other words, the difference between 5.60 per cent and 5.86 per cent registers the additional cost by virtue of having to buy this preferred stock for sinking fund requirements at a premium of $5.00 per share.

Q. The table supporting Chart No. 15 discloses all of the mathematics through which you went to get your final figures, does it not?

A. Yes, it does.

Q. And is the table self-explanatory?

A. I think so. I have listed out each retirement date, the amount involved and explained through the columns how I have used one figure to the next and they are all so captioned that they should be self-explanatory.

Q. What is the cost, then, of this new preferred stock, taking into consideration these items that you have mentioned?

A. The cost will be 5.86 per cent.

Q. That instead of the 5.60 per cent which has been mentioned previously in this record?

A. That is correct.

[fol. 10197] Q. Now, apparently this 5.86 and even the 5.60 are well above the 4.5 per cent that I think was mentioned earlier in the record, is that true?

A. I recall and tried to refresh my memory about the prior discussion that reference was made during the testimony on Exhibit No. 65 to the Exhibit No. 147 which is the Securities and Exchange release and I was asked a question as to whether I had been aware of the fact that certain offers had been made by bankers for a 4½ to 5 per cent preferred stock. In Exhibit No. 147, there is a statement on page 9 carrying that fact and I quote:

"In July, 1939, however, offers were made by banking groups to market a cumulative non-convertible, non participating preferred bearing dividends of 4½ to 5 per cent, the proceeds of which could be used to retire the Class A stock."

Then, as we were discussing that, I think I was asked what I thought this new preferred might sell for, whether or not it could come out at around 4½ per cent and, at the time of the hearing, the bids were opened but they were not opened when I was asked the question but it shows, since we now have the facts on the situation, what the actual cost is as against the presumption that perhaps 4½ per cent preferred stock could have been sold.

Q. Well, I believe you made some statement at the time [fol. 10198] you were examined that you did not believe a 4½ could be sold?

A. That was my general statement, that I felt certain they could not sell a 4½ per cent preferred although I said that if there were sinking funds and so forth involved, it would make a different type of preferred than had been discussed before and those provisions might have some bearing but, even so, I did not think that it would be possible for this company to sell a 4½ per cent preferred stock.

Q. Now, isn't it a fact, Mr. Coffman, that this Chart No. 15 and the four or five subsequent charts in Exhibit No. 253 have been included in this exhibit largely in order to give to Mr. Littman all the facts about this preferred stock on which he was questioning you at the time which you mentioned?

A. Well, that is generally correct, because of the prior discussion and the fact that I did not know what the specific rate might be and thought it wise to wait until the bids were opened. We now have the actual history and, instead of making some conjecture about it, can determine exactly what happened.

* * * * * * * * * * *

[fol. 10199] Q. Then you arrived, mathematically, at a cost of 5.86 per cent, did you, for this preferred stock?

A. That is correct.

Q. That is the cost to the company, is it, at the present time?

A. That will be the cost to the company over the years.

Q. All right.

Now, I take it from Chart No. 16 that that is merely a showing of the 1936-1942 items and the weighted average of historical costs of preferred stock capital, isn't that true? A. Yes, that is correct.

Q. It shows a weighted average of 7.46 per cent, is that correct?

A. That is what is shown in Chart No. 16 in Exhibit No. 253.

Q. Will you turn to Chart No. 17 in Exhibit No. 253 and state what is shown in that chart?

A. The information shown in Chart No. 17 in Exhibit No. 253 captioned, "Record of Sales of Panhandle Eastern Pipe Line Company 5.60 Per Cent Preferred Stock to Public—February 4 to March 30, 1942—Public Offering Price—$104 Per Share", is a new exhibit. There was no [fol. 10200] such data or similar data in Exhibit 65.

Q. It was not available then, was it?

A. It was not available so what I have shown on the one portion captioned, "Report to Dealers and Selling Group Members" is a memorandum which was circulated to the

participating group by Glore, Forgan & Company and Kidder, Peabody & Company as of March 30, 1942.

Q. Who were they?

A. They were the ~~bankers~~ who accepted the original offer to make to the public or rather had their bid accepted in order to secure the issue.

Q. In connection with this new preferred stock?

A. That is correct.

Q. Proceed.

A. This memorandum states:

"To Dealers and Selling Group Members:

"It has been our policy to keep you advised of sales progress and we have sent you reports covering certain dates. We again give you below the sales totals as reported to you previously together with the figure of this date"—

The bankers are there talking about how the sales of the 150,000 shares were going.

On February 4, which is the date of the sale, 74,000 shares were taken or sold.

[fol. 10201] Q. Out of 150,000 total?

A. All these figures relate to the 150,000.

Q. Yes.

Mr. Littman: Pardon me, may I interrupt to ask whether the firm of Glore, Forgan & Company and Kidder, Peabody & Company were the same firms that handled the bonds as well as the common stock?

The Witness: I think that is correct, both firms were in on it.

* * * * * * * * *

Mr. Wheat: I assume by that that you mean they bid on both bonds and the preferred stock and secured the bid?

Mr. Sperry: They were successful bidders.

Mr. Littman: The picture on the over-all deal is not presented here?

The Witness: No, sir, this is the preferred stock only.

Mr. Wheat: We have already discussed the bonds, have we not?

The Witness: I have shown the facts on the bonds and the bonds were sold but the preferred stock is the question.

By Mr. Wheat:

Q. All right. Now, go ahead and tell us what is shown by Chart No. 17?

A. Well, on February 7, it is indicated by this report [fol. 10202] dated March 30, 1942, from Glore, Forgan & Company and Kidder, Peabody & Company to dealers and selling group members that an accumulated total of 83,000 shares had been sold;

On February 14, the total had increased to 93,000 shares;

On February 19, the total had increased to 97,000 shares;

On February 28, the accumulated total had reached 103,000 shares;

On March 14, the total was 110,000 shares, and

On March 30, it was 115,000 shares.

Q. Mr. Coffman, have you taken those figures and those dates and so broken them down by an analysis that you can tell us the average daily sales throughout the period that is covered?

A. Yes, I have. That is also shown on Chart No. 17 in Exhibit No. 253.

Q. What does that show?

A. Well, in the section captioned, "Analysis of Sales February 4, 1942, to March 30, 1942", I show a series of columns; one including the date; the next column showing the trading days, excluding Sundays and holidays; the next column showing shares sold during each period; and the fourth column showing daily average sales.

This shows that after the first initial sale of 74,000 shares, the average daily sales declined 3,000 shares.

Q. What do you mean "declined"? You mean it was [fol. 10203] 3,000 shares during the period February 5 to 7, do you not, Mr. Coffman?

A. I mean to say that, in computing the daily average, a decline in the average daily sales is shown from one period to the next in which these calculations were made.

Q. Yes. Fine.

A. And I want to make clear that the 74,000 shares really is not a daily average because that was the sum total that went out all at once at the opening of the offer, went out on the first day of the sale and then thereafter, the shares sold during each of these periods was taken to find out what the average daily sales would be and those average daily sales declined from 3,000 to 2,000, 1,000, 857, 583 until, as of March 30, the average daily sales had shrunk to 385.

Q. That is true for that fourteen-day period?

A. That is true for the period mentioned.

Q. How many shares were still unsold on the first of April?

A. The number of shares that remained unsold as of April 1, 1942, was 35,000 shares.

Q. Well, what happened on the second of April?

A. In Chart No. 18 in Exhibit No. 253 captioned, "Price to Public of Panhandle Eastern Pipe Line Company 5.6 Per Cent Preferred Stock Reduced on April 2, 1942—Former Price—$104 Per Share—New Price—$100 Per Share;". In other words, the bankers had dropped the [fol. 10204] price $4.00 per share and in this chart is a telegram which states:

"The following is a copy of wire sent to selling group dealers today—

"'You are hereby notified that selling agreement dated February 4, 1942, for Panhandle Eastern Pipe Line Company 5.6 per cent cumulative preferred stock is terminated effective close of business April 1, 1942 a limited amount of such stock has been made available by certain of the original purchasers for offering to approved dealers subject to confirmation by the undersigned as representatives and to your agreement that no such stock will be offered below the public offering price on and after April 2, 1942. The public offering price will be $100 flat—a concession of $1.50 per share will be allowed to you on stock confirmed to you provided such shares are not repurchased for the

account of the several purchasers in the market at or below the public offering price of $100 flat prior to May 15, 1942, or such earlier date as we may determine.

"Stickers for all prospectuses used hereafter may be obtained from the undersigned."

So that this chart shows that as of April 2, the bankers realizing and experiencing what is shown on Chart No. 17 in regard to this slowing up process in the sales in spite of all the effort they put on to sell the issue, decided that if [fol. 10205] they dropped the price $4 per share, it might be somewhat more attractive to the investing public.

Q. By the way, that telegram was signed by Glore, Forgan & Company and Kidder, Peabody & Company, is that true?

A. Signed by Glore, Forgan & Company and Kidder, Peabody & Company.

Mr. Littman: That did not cost the Panhandle Eastern anything, did it?

The Witness: To answer your question, that did cost the company something in this respect, not in dollars, but it is my firm conviction that if this company wishes to issue securities and has any more experiences like this, it is going to be an unpalatable type of security so far as the investing public is concerned.

Trial Examiner: Mr. Coffman, isn't it true that the market right now is the lowest in volume since 1933?

The Witness: I think, generally, that is correct, Mr. Crosby. I do not have the specific figure.

Trial Examiner: And there has been a rapid and alarming deterioration of that market from February 4 consistently to this date?

The Witness: The market, generally, has been declining over a period, including the February 4 period, down to date. That is true.

Trial Examiner: What you have said about the effect of [fol. 10206] this market on these securities would not then necessarily be confined to these securities?

The Witness: With this exception, Mr. Crosby, that here as I see it, we have a new issue and various banking groups bid for it on a closed or sealed bid basis and at the time they did and they certainly must have made some study, they felt that 5.60 per cent basis seemed to approximate what they could do in the way of selling this particular type of preferred stock but subsequent facts have indicated that they could not.

Now, I draw the distinction between a new issue and shares that you can go into the market and buy because these brokers and dealers went directly to their customers to sell the stock and the people bought it at $104 a share but before they have had this stock a month and a half, the bankers who originally sold it to them dropped the price $4. I say if a banking group or a group of brokers on a new issue has very many experiences of that kind, they no longer hold their particular investment clientele as distinguished from being a broker where people call up and say for them to buy so many shares of this, shares already in the market. That is the distinction I want to draw between a new issue and a broker's office where people would call up and say for them to buy ten shares or twenty shares of General Motors or anything else.

[fol. 10207] Trial Examiner: ~~Nevertheless,~~ this is an abnormal market?

The Witness: That is true but this is part of the financing. We have to take the capital markets as we find them when we do the financing.

By Mr. Wheat:

Q. As a matter of fact, Mr. Coffman, even after the price was thus dropped by the bankers, all of those remaining 35,000 shares have not been sold, have they?

A. No. In Chart No. 19 in Exhibit No. 253 captioned, "Record of Sales of Panhandle Eastern Pipe Line Company 5.60 Per Cent Stock to Public—April 2 to April 10, 1942—Public Offering Price—$100 Per Share", I show that the number of shares unsold on April 1, 1942, when the price was reduced from $104 to $100, was 35,000 shares.

The shares sold from April 2 to April 10, 1942, at the reduced price of $100 were 20,000 shares so that the shares

unsold on April 11, 1942, after seven trading days at the reduced price of $100 was still 15,000 shares.

Q. Can you state any later data on that subject?

A. Yes, I asked to have a wire sent me this morning in regard to what the remaining shares were and I have a telegram dated April 17; 10:33, signed by Glore, Forgan & Company addressed to me which reads as follows:

"Response your inquiry most recent check indicates unsold balance of shares of Panhandle Eastern Pipe Line Company 5.60 per cent preferred set aside for dealers plus [fol. 10208] additional shares in hands of underwriters totals in excess of 12,500 shares";

So apparently it is about the same 15,000 shares at the time I checked it last.

Q. Now, have you shown on Chart No. 20 what the effect of these various changes is?

A. In Chart No. 20 in Exhibit No. 253 captioned, "Assumed Cost of Financing Panhandle Eastern Pipe Line Company 5.60 Per Cent Preferred Stock Based on Present Price to Public of $100 and Assumed Price to Company of $95.68" I have concluded that the original offering price was too high and presumably was too high by $4 so I have taken $100 as the price to the public. The underwriting conditions would have remained the same at $3.72; the other expenses of 60 cents would have remained the same, making the assumed net price to Panhandle $95.68 in comparison with the original price which was the actual amount to the company of $99.68 as shown in Chart No. 15. The retirement or call price would have remained the same at $105.

On this basis, making the same calculations as I did before in regard to the sinking fund requirements or calling the preferred stock at a premium, would indicate that 6.24 per cent comes closer to approximating the actual cost on that preferred stock today than did either the 5.60 per cent on which the bids were opened or the 5.86 per cent [fol. 10209] which I calculated in Chart No. 15.

Mr. Lee: Now, Mr. Coffman, will you pardon me if I interrupt here?

Mr. Wheat: I think this is a proper time. We have finished our general discussion on this preferred stock and I think it would be very well—

Mr. Littman: (Interposing) Mr. Lee, I just want to make this observation if I may, in connection with an alleged response by this witness to an alleged inquiry that I made with respect to the preferred stock.

I would like to state that we did not request any further information with respect to the history, the rather sordid history, I should say, of this preferred stock of Panhandle Eastern. We have at all times been in full possession of all the facts.

I would like to point out that the Securities and Exchange Commission in its opinion which is in evidence as Exhibit No. 147 at page 26 said:

"Since April of 1937, various proposals have been made to refinance this Class A stock, all of which is held by Columbia Oil. These proposals and attempts to put out such a refinancing have failed and the history of that failure is a significant indication of Columbia Oil's control over Panhandle Eastern."

[fol. 10210] Now, we have the situation here where this witness is now stating that it has cost Panhandle Eastern close to 6.24 per cent for the refinancing of its preferred stock. This, in the face of the Securities and Exchange Commission's statement at page 9 of its opinion which is Exhibit No. 147 in this case:

"In July, 1939, however, offers were made by banking groups to market a cumulative, non-convertible, non participating preferred bearing dividends of 4½ to 5 per cent, the proceeds of which could be used to retire the Class A stock."

In other words, we claim that it requires a great deal of gall to come in here and claim an extra 1½ per cent of cost for preferred stock and to saddle that 1½ per cent on the rate payer today when the evidence in this case clearly

shows that Panhandle Eastern could have, but for the misdeeds and sins of its parent, Columbia, refinanced this stock at least $1\frac{1}{2}$ per cent below that cost.

Mr. Wheat: Mr. Littman, we certainly are not interested in arguing this case now. If you want to go ahead—but I will say this to you—you will not deny this cost, will you?

Mr. Littman: We certainly shall contend—

Mr. Wheat: (Interposing) You will not deny the dollars of cost, will you?

Mr. Littman: We certainly shall contend that this extra $1\frac{1}{2}$ per cent of cost foisted upon this company by reason [fol. 10211] of the sins of its parent should not be borne by the rate-payer, as this witness contends.

Mr. Wheat: Do you deny this cost?

Mr. Littman: Yes, sir, for purposes of this proceeding.

Mr. Wheat: For purposes of any proceeding, do you deny these dollars are being paid and have to be paid?

Mr. Littman: It is being paid because of the sins of the parent.

Mr. Wheat: It is being paid, is it not?

Mr. Lee: It is right on that point—

Mr. Wheat: (Interposing) I am not going to argue this case now but I do not think we ought to have that kind of remarks in this proceeding at this stage.

Mr. Littman: Wherein have I not spoken the truth?

Mr. Wheat: You have not spoken the truth when you have intimated there has not been this cost and, only after many questions that I asked you, have you said there has been this cost.

Mr. Littman: Of course, there is this excessive cost which was occasioned by reason of the misdeeds of the parent company.

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[fol. 10212] By Mr. Wheat;

Q. Mr. Coffman, will you turn to your Chart No. 21, in Exhibit No. 253, and first state whether this chart, in effect, brings down to date the respective Charts 19 and 20 which were included in Exhibit No. 65?

A. Yes, it does.

Q. What does it generally show?

A. Chart No. 21 in Exhibit No. 253 captioned, "Earnings—Price Ratios of Natural Gas Pipe Line Company Common Stock—1937-1941" shows the earnings-price ratios for each of the years mentioned on the El Paso Natural Gas Company, Interstate Natural Gas Company, Memphis Natural Gas Company, Northern Natural Gas Company, Southern Natural Gas Company and Panhandle Eastern Pipe Line Company.

Q. I believe you explained previously why you chose those particular companies; did you not?

A. That was explained in connection with the discussion of Chart No. 19 in Exhibit No. 65 and all I have done is proceeded to add on the full year 1941 which could not be done at the time Exhibit No. 65 was prepared.

At that time, as shown in Chart No. 20 in Exhibit No. 65, I had to use interim figures covering January 1 to August 31, 1941. In Chart No. 21 in Exhibit No. 253, I [fol. 10213] have the full year figures and there, because of questions that were asked before, I have shown both the simple average and the weighted average right in the chart so the figures would be available.

Q. Whether anyone asked you to do that or not, you have done it, haven't you?

A. That is correct.

Q. And you now show it both ways?

A. I show it both ways.

Q. Yes. What would you say with respect to what is shown by the data which you have been able now to include for the year 1941?

A. Chart No. 21 in Exhibit No. 253 shows, if you refer to the average figures, whether they be simple averages or weighted averages, that the common stocks are still showing 12 per cent. The figures for 1941 indicate that, for the individual companies, there was smoothing out of differences from one company to another as existed in some of

the prior years but the important thing is that, over the five-year period, these data indicate that, so far as the averages are concerned, they are running along the same levels.

Q. I think you were questioned before concerning something about Southern Natural Gas Company. That has come down, hasn't it?

A. Southern Natural Gas Company is bar No. 5 in each of these boxes and the figure has come down from a level of [fol. 10214] 21.60 per cent in 1939 to 14.73 per cent in 1941.

Q. Now you were also questioned, I believe, at some length about Interstate Natural Gas Company. What happened to that? And you were questioned about Memphis Natural Gas Company. What happened to that?

A. Interstate Natural Gas Company is the second bar in each of the boxes and that was at a low of 8.90 per cent in 1939 and increased so that, in 1941, it was 10 per cent.

Q. It was at a really lower low of 8.67 in 1940, wasn't it? A. That is correct.

Q. In other words, those extremes are apparently leveling out some, are they not?

A. That is what the box showing the 1941 figures would indicate.

Q. But I think you have said that although there is this general evening out, that 12 per cent remains as the investors' appraisal of risks in these stocks.

A. That is what the data on the averages here would indicate.

Q. And would you say, as you have already put it today, that this is what investors actually demand?

A. I have merely recorded here the earnings-price ratio which is an objective test, merely saying what the investors are saying about these common stocks of these companies [fol. 10215] listed.

Mr. Littman: Are those judgment figures?

The Witness: No, this is just arithmetic.

Mr. Littman: I meant the 12 per cent.

The Witness: The 12 per cent, I have just used a round figure based on these averages shown here which are either, depending on which average you use, above 12 or a little below it.

Mr. Littman: In other words, the 12 per cent, as I understand it, represents your judgment based upon these data shown in Chart No. 21?

The Witness: That is correct and I come to a chart in which I make that point.

Mr. Wheat: Well, but the simple average in 1941 was 12.70 per cent and the weighted average was 11.98 per cent, was it not?

The Witness: That is correct.

Mr. Lee: Pardon me, I would like to ask a question.

Mr. Wheat: Yes.

Mr. Lee: Is this 12 per cent, is that the average return earned on the common stock of these companies?

The Witness: That is the relationship of the price, the quoted market price to the earnings. In other words, it is the amount that the investors now are having by way of yield on the securities, the common stock.

Mr. Lee: And yet ~~with that~~ condition, you say you are [fol. 10246] claiming that the underwriters cannot dispose of the balance of the stock?

The Witness: Of course, we are talking about two different things. We were talking about the preferred stock and here we are talking about common.

Mr. Lee: Yes, but which is the better offer, the preferred or the common?

The Witness: Well, you cannot make a comparison of that kind because the 12 per cent may represent what the investor actually says he is willing to invest money at at this particular time and this particular risk but the investor, as I have shown in the preceding charts related to preferred, so far as 5.60 per cent preferred stock with sinking fund provisions, he does not like it so that means the 5.60 was too low. Otherwise, the preferred stock issue should have sold in a few days and certainly in not more than a couple of weeks.

By Mr. Wheat:

Q. Now, will you turn to Chart No. 22 and state what that shows and how that refers back to your Chart No. 21?

A. Chart No. 22 in Exhibit No. 253 captioned, "Average Earnings-Price Ratios of Natural Gas Pipe Line Company Common Stocks—1937-1941" merely summarizes the figures, the average figures which are shown in Chart No. 21. In other words, I merely wanted to make the average [fol. 10217] figures clear so that the weighted average on what would be termed the weighted average of simple averages shows 13.31 per cent for the five-year period, 1937-1941, both inclusive, and the weighted average shows 11.96 per cent for the same period.

Q. As a matter of fact, as we look across these two sub-charts of Chart 22, there are relatively small fluctuations over the five-year period, is that not correct?

A. I would say that the fluctuations shown therein are very small. I think the widest one shown involves a point and a half, from one year to another.

Q. Do you consider that fact significant?

A. It indicates to me that the period 1937 to 1941 apparently has not had any peculiar circumstances surrounding it. I mean a five-year period in which the figures all fall within a point and a half of each other would indicate some degree of normalcy about this particular phase of the problem.

Q. All right.

Now, turn to Chart No. 23 and state just what that shows.

A. Chart No. 23 in Exhibit No. 253 captioned, "Accepted Earnings-Price Ratio for Panhandle Eastern Pipe Line Company Common Stock" shows 12 per cent which is the figure I took to represent what the investors' appraisal is for common stocks of a natural gas pipe line company and that figure was accepted because of the data shown in Charts Nos. 21 and 22 which indicated that to be the round percentage representing the investors' appraisal of the [fol. 10218] risks connected with common stocks in the natural gas industry.

Q. As a matter of fact, Mr. Coffman, this does not include any amount for costs of financing common stocks, does it, or anything of that sort?

A. No, this is based upon the quoted market prices and the earnings and has not anything to do with new issues that came out or the cost thereof.

Q. You simply used the earnings-price ratio and taken this directly from those?

A. That is correct.

Q. In this business during the past five year period?

A. In this industry during the past five-year period.

Q. In this industry?

A. That is correct.

Q. Now, will you turn to Chart No. 24 and state what that shows?

A. Chart No. 24 in Exhibit No. 253 captioned, "Minimum Earnings Required for Common Stock of Panhandle Eastern Pipe Line Company" shows the total amount of common stock and surplus as of February 28, 1942, which is the consolidated figure in the amount of $28,574,090 and, to that, I have applied the 12 per cent ratio which shows that the amount of earnings required for the common stock and surplus would be $3,428,891.

[fol. 10219] Q. All right. Now, that is purely an arithmetical calculation?

A. That is merely multiplying the $28,574,090 which is taken from Mr. Watkins' exhibits by the 12 per cent which I have just secured from the preceding exhibits to give me this resulting figure of $3,428,891.

* * * * * * * * *

Mr. Littman: (Interposing) Pardon me, Mr. Wheat, I would like to ask a clarifying question with respect to Chart No. 23.

Did I understand you to make a statement in connection with this 12 per cent, the earnings-price ratio for Panhandle Eastern Pipe Line Company common stock, that it did not include the cost of financing or that it did include the cost?

The Witness: It did not. In other words, it is based on quoted market prices as given over the Exchanges in comparison with the earnings available. In other words, all these securities I am using, you see, are not new issues so I have no opportunity to calculate cost of financing. I am merely taking the stocks on the market and their prices.

Mr. Wheat: At least you did not calculate any cost of financing and add them on?

The Witness: I had no way to make such a calculation.

Mr. Littman: Do you show anywhere in your exhibits the cost of financing the common stock?

[fol. 10220] The Witness: The only one that I had available to me was the one that I showed in Exhibit No. 65 in regard to that Northern Natural issue.

Mr. Littman: I recall that.

The Witness: That is the only one.

Mr. Wheat: That is shown, is it not, on Chart No. 21 of Exhibit No. 65?

The Witness: Yes, that is correct, Chart No. 21 of Exhibit No. 65.

Mr. Littman: Apparently you do not consider it necessary to show the cost of financing of common stocks and the effect on the earnings requirement?

The Witness: I think it is very good if you have the figures to do it but, if you do not have the figures to do it, you cannot do it.

Mr. Wheat: At any rate, you have not done that and, therefore, you have not added anything in to your 12 per cent for that item?

The Witness: No, and the point must be true without calculations that if you took out costs of financing, the percentage would be higher rather than lower, obviously, because you would make the calculation then on the net price to the company.

Mr. Littman: Mr. Coffman, I would like to have you clear me up on this point. Is it or is it not necessary, for [fol. 10221] purposes of these studies which you have submitted, to take into account the cost of financing with respect to the common stock?

The Witness: If I could get the figures, I would make such calculations.

Mr. Wheat: But it would increase your 12 per cent to something higher than that, would it not?

The Witness: That is correct. The point is that there have not been many new issues. The Northern Natural was the one most recent to the date of the case at the time we were having the last hearings and there is no way that I know of, until such issues come out, that you could make such calculations and I do not see, on an issue which came out many years ago, where it would be pertinent now. If you could get a new issue and make your calculations now, that would be the very best test you could get.

Mr. Littman: It seems to me it is my recollection when you testified when you were last on the stand under cross-examination, that your 12 per cent included the cost of financing the common stock. Is my recollection correct?

Mr. Wheat: I think, if you are going to ask him a question like that—I have no such recollection—you ought to cite chapter and verse because I am quite sure it is not in the record and I just now asked if he did it in this calculation and he has answered, "No".

[fol. 10222] The Witness: The earnings-price ratios are used throughout. There is no way that I have of making such calculations. Where there were issues available, new, such as this preferred or the common stock of Northern Natural, obviously with all facts available, I could do it.

Mr. Littman: The record speaks for itself. I merely wanted my recollection refreshed. Inasmuch as I have this impression, I thought perhaps he might clear me up on it.

The Witness: I do not believe I said anything like that. I would have to read the record myself.

By Mr. Wheat:

Q. Mr. Coffman, if you used earnings-price ratios, as such, and adopted your 12 per cent both before and now from earnings price ratios, as such, then clearly you did not include any cost of financing the common stock, did you?

A. That is a correct statement.

Q. Now, turn to Chart No. 25 of Exhibit No. 253 and state whether that is, in general, similar to Chart No. 26 in Exhibit 65 except, of course, that it applies to Panhandle Eastern Pipe Line Company as it now exists. Is that correct? A. Yes, that is correct.

Q. Would you say that the $5,325,677 which you have labeled, "Earnings Required to Maintain Credit Position" compares with the $5,077,648 marked or labeled, "Earnings Required to Maintain Quality" in the earlier chart?

[fol. 10223] A. Yes, I think it compares with that figure.

Q. How did you arrive at that figure of $5,325,677?

A. In Chart No. 25, Exhibit No. 253, captioned, "Minimum Earnings Required to Maintain Credit Position of Panhandle Eastern Pipe Line Company", I show, as of February 28, 1942, the total invested capital of $77,830,535. Included in that total invested capital were bonds in the amount of $33,256,445 and I had already shown that the cost was 2.88 percent for that portion of capital, so I merely took 2.88 per cent of the bond total to ascertain what was required for that part of the capital structure, so far as the investor was concerned. In the total invested capital was preferred stock in the amount of $16,000,000 and I applied the rate to that, the rate I have discussed, of 5.87 percent.

Q. What was that?

A. That is the cost of the preferred stock.

Q. To Panhandle Eastern Pipe Line Company, is that correct? A. That is correct.

Q. All right. What else did you do?

A. And then I applied the 12 per cent figure to the equity of $28,574,090 and took the sum of those three multiplications which gave me a total of $5,325,677 which I called the earnings required to maintain credit position on that basis.

Q. Now, how does Chart No. 26 in Exhibit No. 253 dif- [fol. 10224] fer from Chart No. 25?

A. Chart No. 26 in Exhibit No. 253 captioned, "Minimum Earnings Required to Maintain Credit Position of Panhandle Eastern Pipe Line Company Based on Actual Cost of Bonds and Investors' Appraisal of Preferred and Common Stock" differs from the data in Chart No. 25 to the extent that I took the 6.23 per cent which is what the

current market conditions are evidencing in regard to the preferred stock and applied that as the investors' appraisal. The total earnings required by that change were $5,382,677 and that figure, in my opinion, represents the earnings that are required by the company to maintain the credit position.

Q. All right.

Now, will you turn to your Chart No. 27, Mr. Coffman, and state first why you included this and the succeeding five charts in Exhibit No. 253 and then state what Chart No. 27 shows?

A. In Exhibit No. 253, I present a series of charts covering, from Chart No. 27 through Chart No. 35, on money rates and the trend of money rates and the purpose of inserting these charts was to show that there has been, in the earlier years, a downward trend, a very substantial downward trend in money rates but that, in the last few years, such rates have been leveling off, going from what would be termed the shortest term and best money to longer term and more hazardous money through [fol. 10225] corporate financing.

Q. I believe you answered previously in this record, in response to a question by the Presiding Examiner, that there has been a reduction in money rates over the past several years, did you not?

A. Yes, I think I mentioned that.

Q. And these charts reflect in detail what those changes have been, do they not?

A. That is correct.

Q. And show, for all these types of use of money, what has actually been the experience?

A. That is correct.

Q. Now, will you turn to Chart No. 27 and tell us in some detail what that shows?

A. Chart No. 27 in Exhibit No. 253 captioned, "Prime Money Rates Monthly, 1930 to March, 1942" shows the money rates on 60 to 90 day time loans of the New York Stock Exchange, the call loan renewals of the New York Stock Exchange and four to six months prime commercial paper. These are what you might term the shortest term and highest grade money.

The chart shows that four to six months commercial paper (prime) was carrying a rate as of February, 1942, of 0.56 per cent and that call loan renewals of the New York Stock Exchange were carrying a rate of one per cent and that 60 to 90 day time loans were carrying a rate of 1.25 per cent.

[fol. 10226] Q. Does that, in itself, show an investors' appraisal?

A. That indicates that investors are drawing a distinction between the type of loans they are making.

Q. As a matter of fact, Mr. Coffman, the spread between the three different types of paper that are shown on this chart at the present time is greater, by a considerable amount, than the spread between a similar type of paper back in 1930?

A. Well, in January of 1930, the lowest rate there applying to call loans was 4.64 per cent and the highest rate, which applied to four to six months commercial paper, showed 4.85 per cent or approximately 0.20 per cent difference.

In February of 1942, the lowest rate was, four to six months commercial paper (prime) at 0.56 per cent and the highest was on 60 to 90 day time loans at 1.25 per cent or almost 0.70 per cent spread.

Q. As a matter of fact, although there have been large reductions in the interest rates on such so-called prime money, there has been a very definite leveling out over the past few years, has there not?

A. Yes, I think the exhibit shows that pretty clearly.

Q. Now, will you turn to Chart No. 28 and tell us whether somewhat similar facts are reflected by the chart there dealing with commercial loan rates?

A. In Chart No. 28 of Exhibit No. 253, I show commercial loan rates charged customers by banks in principal [fol. 10227] cities, by months, 1930 to and including 1942 to the date of this exhibit.

Q. This also shows that there has been a considerable drop in these rates, does it not, but that there has been, over the past several years, a very marked leveling out of such rates?

A. Generally that is true. Included in the rates are rates for eleven cities, eleven southern and western cities, seven other northern and eastern cities and for New York City and in recent years, there has been more of a leveling out but it still shows that rates charged customers by banks vary in different parts of the country and there is a spread as of January 1942, from 1.88 per cent to 2.99 per cent.

Q. Well, otherwise, that chart seems to be self-explanatory, does it not?

A. I think so, and the detailed indexes or figures are all in the tables.

Q. Would you say that your Chart No. 29, which deals with yields on United States Government and high grade municipal bonds also shows a reduction in general interest rates on such paper but a somewhat general leveling out over the past three or four years and also a spread of investors' appraisal of such paper?

A. I think so. Chart No. 29, showing "Yields on U. S. [fol. 1022] Government and High Grade Municipal Bonds, Monthly, 1930 to March 1942", shows short term United States Government bonds which are about 3½ years maturity, intermediate term United States Government bonds which are about 7½ year maturity; long term United States Government bonds which are anything over ten years, and municipal bonds and, aside from the trend which has been down, but leveling out in recent years, it shows very definitely that investors are appraising those different types of monies at different risk factors.

Q. As a matter of fact, the spread of investors' appraisal is here again much greater in February, 1942, than it was back in 1930, is that not correct?

A. That is correct. The shortest term money which presumably has the least risk shows the lowest rate and the municipal bonds, which the investors believe have the greatest risk, carry the highest rate.

Q. Will you turn to your Chart No. 30 which, I understand, deals with the highest grade of industrial or corporate bonds and state what is shown on that chart?

A. Chart No. 30, Exhibit No. 253, captioned, "Standard's Highest Grade (A1 plus) Corporate Bond Yields Monthly, March 1930 to March 1942", there is a comparison of high grade corporate yields between industrial

bonds, railroad bonds and public utility bonds and that shows in February of 1942 that industrial bonds carried [fol. 10229] the lowest rate, public utility bonds carried a higher rate and the railroad bonds carried the highest rate of those three. In other words, investors were continuing to exercise their appraisal as between these different types of investments as a class.

Q. Here again, do we find that the spread of that appraisal in 1942 was greater than it was in 1930?

A. Yes, it is.

Q. As a matter of fact, during such period as 1936, the spread was very, very slight, was it not?

A. Yes, it was less than since, beginning around 1938.

Q. On these highest grade A1 plus corporate bonds, is the composite figure now 2.88 per cent?

A. That is correct. That is just the composite index figure of the industrials, public utilities and railroad bonds.

Q. Here again do we find that, as Examiner Crosby pointed out when you were on the stand before, there has been a considerable drop in interest rates over the years?

A. That is shown here.

Q. But does it also appear that there has been a rather general leveling out of such rates over the past two or three years?

A. I think that is indicated in the chart.

Q. Now, will you turn to Chart No. 31 and state what is shown there?

[fol. 10230] A. In Chart No. 31 of Exhibit No. 253 captioned, "Standard's Corporate Bond Yields—By Quality Rating Monthly, 1937 to March, 1942", is shown the yields on various quality groups, Composite A1 plus, A1, A, B1 plus, B1 and B.

Q. What do you mean by those letters?

A. Those are the ratings that are assigned because of the peculiar situation of a bond, so far as a number of tests are concerned and the bond that is in the best position, from the standpoint of its relation to earnings, interest coverage and so forth, carries the highest quality rating, A1 plus, and so forth. They are graduated downward in the various quality rating scales as their position is less worthy than the higher grade bonds.

Q. Well, throughout this chart over all the years, have investors' appraisals of these various types of bonds followed very distinctly these very classes, classifications?

A. I think the chart makes that very clear. The lines have never crossed, for one thing. Secondly, the highest grade bond has always carried the lowest rate and the more speculative bond tends to get, as you approach a quality rating of B, a higher rate so ~~that~~, in February and March of 1942, Composite A1 plus, corporate bonds were yielding 2.88 per cent and they graduate up the scale of per cent as the quality rating goes down so that bonds, carrying B quality ratings were demanding 6.79 per cent.

[fol. 10231] Q. In each instance, these are yields to maturity based on market prices, are they not?

A. That is correct.

Q. For every month of the chart?

A. That is correct.

Q. In other words, would it be fair to say that an average bond which, because of earnings or coverage would be classified as B1 would, in the present market, cost around 5⅓ per cent?

A. If the bond had no peculiar qualifications which might take it into some special class, you would assume that 5.32 per cent was approximating the type of rate the bond would have to carry if it were to find a market at the present time.

Q. And if it were so much more speculative that it would be classified as B, it would have to carry a rate of almost 7 per cent, wouldn't it?

A. As indicated here, the B quality rating carries 6.79 per cent so it would be somewhere between 6¾ and 7 per cent.

Q. Now, are similar investor appraisals of bonds in the public utility field also shown in your Exhibit No. 253?

A. Yes. Those are shown in Chart No. 32 captioned, "Standard's Public Utility Bond Yields—By Quality Rating Monthly, 1937 to March, 1942".

[fol. 10232] Q. And these carry the same types of quality rating; do they not?

A. That is correct.

Q. And the spread is between 2.77 per cent for A1 plus public utility bonds and, in February, 1942, to 6.45 per cent for Class B public utility bonds at that time?

A. That is correct.

Q. And the rest fall in between, as shown on the chart?

A. That is correct, and as the details are shown on the table.

Q. Will you turn to Chart No. 33 and state what that is and the source?

A. In Chart No. 33 of Exhibit No. 253 captioned, "Bonds, Debentures and Notes Issued by Natural Gas Companies—1936-1941", there is a tabulation taken from the Securities and Exchange Report in which they listed all of the bonds, debentures and notes issued by natural gas companies for the period mentioned. To that, in our analysis, we added certain securities which they had not included to make the list as complete as it could be made.

Q. Are those shown on Chart No. 34?

A. The list is shown in Chart No. 34.

Q. All right.

What does your Chart No. 33, in general, show?

A. Well, is shows that the average yield on bonds and [fol. 10233] debentures, based on price to public as represented by the green line, had showed a decline from 4.59 per cent, on the average in 1936, to 3.11 per cent in 1941.

Q. Is there anything you think you should state about that chart?

A. Not particularly. It indicates that the general rates have been down but even on these new issues in 1941, the rate was still a little above 3 per cent and when you look at the quality ratings for each of those issues, which I show on a later chart, you can find there are some rather wide variations in quality ratings and wide variations in investors' appraisal.

Q. You are referring, are you not, to your Chart No. 35?

A. That is correct.

Q. Will you now state what is shown on Chart No. 35?

A. In Chart No. 35 in Exhibit No. 253 captioned, "Yields on New Security Issues of Natural Gas Companies According to Quality Rating—1936-1941", I merely took the list of securities as reported by the Securities and Ex-

change Commission, added thereto some securities which were issued which they had not included and then analyzed them from the standpoint of their quality rating for each of the years.

Mr. Littman: Pardon me, Mr. Coffman, I would like to ask one question about Chart No. 34.

You have not included in that chart the Natural Gas Pipe Line Company of America notes secured by bonds [fol. 10234] issued in 1941. I wondered why you did not include those under your year 1941?

The Witness: The only answer I can give you at the moment, Mr. Littman, is that we went through all of our files and apparently we did not have the release of information on that at the time we made the study because I combed every particular copy we had in the file and I do not think I missed any so, if I do not have it, it is because we have not yet received any information on it.

Mr. Wheat: It is not in the list given by the S. E. C., is it?

Mr. Littman: I believe it was exempt from S. E. C.?

Mr. Wheat: That is what I thought, yes.

Mr. Littman: Would you please respond to this request? Will you please verify my understanding that Natural Gas Pipe Line Company of America issued, in the year 1941, something like seventeen and one-half million dollars of one and three-quarter per cent serial notes?

Mr. Wheat: We will be glad to check on that.

The Witness: We do not have it in the file. If they were privately sold, we would not have the information.

Mr. Littman: In other words, that information would not come to you through the ordinary and usual channels but will you please check and ascertain the facts?

[fol. 10235] The Witness: Yes, I will see if I can get the facts.

Mr. Littman: That is about as low a cost of financing funded debt as you know, is it not, for a natural gas pipe line company, 1¾ per cent?

The Witness: I would say that was.

By Mr. Wheat:

Q. Let's go back to Chart No. 35, Mr. Coffman. Will you go ahead and state what is shown on that chart?

A. I think I had already stated I took the list as shown in Chart No. 34 and broke it down according ~~to quality ratings for each of the years.~~ I do not think it is necessary to go through each year. If I explain one, you will get the idea of how the table is made up.

In 1936, this indicates that the securities which were issued, one issue carried an A rating, the per cent of which was 4.18 per cent and that is at the top of the box and the rating is below with the per cents shown at the top of the bar. There were four issues of B1 plus carrying a rate of 4.59 per cent. There were two issues carrying a rating of B1 and a per cent of 4.80 per cent and two issues carrying a rating of B and a per cent of 4.91 per cent.

In 1937, it is evident there were four issues but only one quality rating. The four issues that came out carried B1 plus and a per cent of 4.31 per cent so that, as you go through each of the years analyzing these new issues, not [fol. 10236] generally but more specifically as to their quality rating a person can then get a better idea of what the investor was saying about those particular securities.

Q. Are these quality ratings well recognized things in the financial markets?

A. Well, quality ratings are at least 25 years old, if not older and, secondly, banks are very definitely regulated in regard to bonds so that if they buy certain bonds which carry a rating of less than B, they are immediately classified as substandard and speculative and they do not qualify for bank investment so, for any bond to carry a quality rating for bank investment, it must be rated B1 plus or better so that gives a pretty good idea of the importance of ratings.

Q. That importance is clearly shown, is it not, for example, in 1941 in the difference in cost between the four B1 ~~plus~~ issues and the one B1 issue there?

A. That is correct.

Q. And the A1 issue in 1941 had the highest rating and, as was to be expected, the lowest in cost?

A. That is correct. The ratings are one measurement of the risk that is involved and the greater the risk, the greater the rate has to be.

Q. Now, will you turn to Chart No. 36 and state how that chart discloses, graphically, what you have just been [fol. 10237] saying with respect to ratings of bonds?

A. In Chart No. 36 of Exhibit No. 253 captioned, "Ideal Earnings Coverage Ratios for High Grade (A Group) Natural Gas Company Bonds as Submitted to the New York State Bankers Association for Qualifying High Grade Bonds", in 1939 at the annual meeting of the New York State Bankers Association, they were trying to refine their processes of classifying bonds to enable bankers to be better safeguarded in their investment and these ratios here shown in Chart No. 36 show two methods of checking the position of a bond, particularly as it relates to natural gas company bonds.

On the left-hand side, it shows the fixed charges times earned and there, we are not referring to a single year but, as shown in the note, considering an average for the last six years with latest year results at least as good as average. Retail distributors in the gas field, 3.5 times—

Q. (Interposing) This is for the A rating?

A. This is for the A group as shown in the caption.

For integrated companies, 4 times; for pipe line wholesalers, 4 times.

Another check is that made by considering the income available for fixed charges to par value of fixed debt, and here again, as explained in the note, it is the average for the last six years with latest year results at least as good as average.

[fol. 10238] Q. What are those particular percentages?

A. For retail distributors, 14 per cent; integrated distributors, 16 per cent; pipe line wholesalers, 16 per cent.

Q. Now, may I ask, Mr. Coffman, whether either one of these two tests of bonds carry a greater weight in the rating or are both important and essential?

A. No, the Association uses the ratings and the investors look at them or we use them to advise investors. We look at both.

Mr. Littman: Will you submit to us the source of the data and information shown in Chart No. 36?

The Witness: Well, I can give you one source now. The original discussion is in the Annual Proceedings of the New York State Bankers Association for 1939 but, in our own service, we have taken all of this out and I can leave this copy with you which is Standard's Corporation Records, Current News Edition T to Z, Special Table Section in which, on page 5, there is a section captioned, "Bond Quality Yardsticks" and this explanation:

"In the Spring of 1939, the New York State Bankers Association pioneered a new approach to the problem of determining the relative suitability of individual bonds for inclusion in bank bond accounts. Standard & Poor's Corporation has had the privilege of working in close cooperation with the Bond Portfolio Committee of this Association in establishing, for this purpose, concrete meas- [fol. 10239] ures of bond quality", and then a detailed explanation of these items is given so I think that should answer your question.

Mr. Wheat: Does that show these figures that you have shown on Chart 36 of Exhibit No. 253?

The Witness: Yes, on page 9, the discussion begins on natural gas companies and runs over on to page 10 and the per cents shown in here are contained in the written matter on page 10.

Mr. Littman: Are you saying that the New York State Bankers Association specifically discussed pipe line wholesalers?

The Witness: No. At the Proceedings in 1939, they developed this method of ratios to test bonds and worked out a formula and that formula we have applied throughout all bonds. They did it on one series. We worked it out on all series for them.

Mr. Littman: By pipe line wholesalers, do you mean natural gas pipe line wholesalers or others?

The Witness: No, I would include all natural gas pipe lines.

Mr. Littman: But does that mean that it would include other pipe line wholesalers as well, such as oil?

The Witness: No, this is talking about natural gas here altogether.

Mr. Littman: In other words, the "Pipe line wholesalers" refers specifically to natural gas?

[fol. 10240] The Witness: Well, that is stated clearly in the caption there, Mr. Littman.

Mr. Littman: I see.

Now, what do you mean by "integrated"?

The Witness: That is where a pipe line might be performing two functions, part of it is wholesaling and some other portion of it retail distributing.

Mr. Littman: And the bankers do not show any difference in risk as between the "integrated" and "pipe line wholesalers" as you do in your study of investors' appraisal of risks?

The Witness: For integrated and pipe line wholesalers, so far as ratios are concerned, there is no distinction drawn, so far as this formula is concerned, that is true, but this is not the investors' appraisal that I have been talking about. This is merely a guide that they are using as to a quality yardstick that must be met to qualify a bond on a quality rating.

Mr. Wheat: May I suggest, Mr. Coffman, the retail distributors are given a different percentage and times earned, are they not, as compared to the pipe line wholesalers and the integrated companies?

The Witness: Yes, there is that difference but I said there was no difference between integrated and pipe line [fol. 10241] companies.

[fol. 10242] By Mr. Wheat:

Q. Mr. Coffman, will you turn now to your Chart No. 37 and state what that shows?

A. In Chart No. 37 in Exhibit No. 253 captioned, "Debt Coverage Ratios for El Paso Natural Gas Company Actual and Adjusted to a 6½ Percent Rate of Return", I have taken the El Paso Natural Gas Company and the total invested capital as shown by the books, which amounted to $23,748,010, invested capital here being computed on the basis of the net debt, preferred stock, common stock, and surplus.

In the second column, I show the actual dollar return on invested capital which amounted, according to the company's report, to $2,610,478. Then I applied 6½ percent to the total invested capital of $23,748,010, which gave an assumed return of $1,543,621. The bonds outstanding of the company carried actual fixed charges in the amount of $415,877.

Q. What were the ratios to be found from those figures?

A. In the second column, I show the actual computation of the ratios which would, on their reported earnings, show that fixed charges were earned 6.28 times and that the income available to par value of debt was 21.80 percent.

Q. Now, in your next group of two bars, I notice it is headed, "Actual Ratios." Didn't you mean "Ideal Ratios"?

A. Those were the ratios discussed in Chart No. 36 dealing with the New York State Bankers Association.

[fol. 10243] Mr. Littman: Should we correct our exhibit, Mr. Wheat?

Mr. Wheat: Yes.

* * * * * * * *

By Mr. Wheat:

Q. Now, you have shown those same ratios and times earnings in that group of two bars that you showed on Chart 36, haven't you?

A. Yes, that is correct.

Q. Now, what are the last two bars on this Chart No. 37?

A. Well, I have taken the assumed return on the $6\frac{1}{2}$ percent basis of $1,543,621, used that for the basis of the calculation in which case the fixed charges would then be earned 3.74 times and the income available to par value of debt would then be 12.89 percent.

Q. What does that figure show you?

A. It would indicate that in that return both the times earned and the income available to par value of debt would be lower than the ideal ratio which would indicate [fol. 10244] that the ratings on the bonds would be lowered, and, as I have shown in the yield charts, whenever, the rating on bonds goes lower, the yield goes up.

Q. This does not assume anything about income tax changes, or anything of that sort, does it?

A. No, sir, this is just simple arithmetical calculations as I have indicated.

Q. Now, on Chart No. 38, have you gone through similar calculations with respect to Northern Natural Gas Company? A. Yes, I have.

Q. And does that show that with the same assumed return, those bonds would fall below these so-called ideal ratios?

A. Yes, it would show a substantial reduction from what they actually show now and, so far as the fixed charges times earned figure is concerned, although it would be lower on the assumed return than the actual return, it would still be a little higher than the ideal 4 times, but, looking at the income available to par value of debt, the figure would be 14.8 percent, which would be below the 16 percent on the ideal basis so that there would be the question of reduction of quality rating on that bond should these results become actualities.

Q. How about Chart No. 39 which I think deals with Southern Natural Gas Company?

A. In Southern Natural Gas Company, as shown in [fol. 10245] Chart No. 39 in Exhibit No. 253, the fixed charges times earned on their present reported earnings are below the 4 times on an ideal ratio basis and, if you assume a return of $6\frac{1}{2}$ percent, the times earned would be reduced to 2.23 times and the income available to par value of debt would be 12.69 percent. In other words, that bond also would carry quite a reduction in rating if that assumed situation were to become real.

Q. Is that a similar result and similar reaction upon ratings which is shown on your Chart No. 40 with respect to Cities Service Gas Company?

A. Yes, the same result is shown there.

Q. Both the times charges earned and the income available to par value of debt are below the ideal ratio for a bond?

A. That is correct.

Q. How about Chart No. 41, Mississippi River Fuel Corporation?

A. The same thing holds true in the case of Mississippi River Fuel Corporation as shown on Chart No. 41 of Exhibit No. 253.

Q. I wish you would explain your Chart No. 42, please.

Before you do that, is it a fact, then, that as to each one of the companies considered in Charts 37 to 41, inclusive, should the rate of return be fixed at 6½ percent, the bonds would fall under the ideal ratio for A bonds?

A. Yes, they would.

[fol. 10246] Q. Now, what is shown on your Chart No. 42?

A. In Chart No. 42 of Exhibit No. 253, captioned, "Debt Coverage Ratios for Natural Gas Companies Adjusted to 6½ Percent Return on Net Property and Working Capital", I have gone through the same procedure to get at the effect of the 6½ percent return but have calculated invested capital as defined by the net property and net working capital instead of the capital structure which was used in the others.

Q. Did you find a somewhat similar result over all of these companies?

A. Yes, I did, and the figures are shown completely in that table.

Q. And from those figures, would you conclude that the rating on these bonds would have to be changed?

A. Yes, the same effect would work out here as worked out in the preceding charts that, in most instances, the ideal ratios would not be met, which would indicate that, should such condition become a reality, the quality rating would be lowered.

Q. And the cost, therefore, raised?

A. That is correct.

Q. Now, I wish you would turn to Chart No. 43, Mr. Coffman, and state what is shown on that chart.

A. On Chart No. 43 of Exhibit No. 253, captioned "Debt Coverage Ratios of Panhandle Eastern Pipe Line [fol. 10247] Company at Various Levels of Net Operating Revenue", I have taken, in the first two columns, the actual results for the 12 months ended February 28, 1942, which is the consolidated company, and shows the net operating revenue as reported on a consolidated basis of $6,361,247 and, on the basis of the 1941 tax rates, shows that fixed charges would have been earned 7.19 times and that the income available to par value of debt was 19.13 per cent.

In the next group, I have made the same calculations except that I used the proposals made by Secretary of Treasury, Mr. Morgenthau, to see what effect, on the basis of operations ended, for 12 months, February 28, 1942, such tax would have. The net operating revenue on that basis would then total $4,526,619 or about $1,800,000 less than on the basis of 1941 rates. On the $4,526,619 of net operating revenue, fixed charges would be earned 5.12 times and the income available to par value of debt would be 13.61 percent.

Q. That would be under the ratio of the New York State Bankers Association?

A. The income available to par value of debt would then be under that ratio.

Q. All right, proceed.

A. Then, in the next part of the exhibit, I show the minimum earnings necessary to maintain credit position which is the $5,382,677 which I have shown previously in [fol. 10248] Chart No. 26 and, on that basis, the fixed charges would be earned 6.09 times and the income available to par value of debt would be 16.19 percent, just about even with the ideal ratio.

Q. And, in that instance, should that net minimum earnings be actually earned, the bonds would not lose an A rating, would they?

A. No, the bonds on that basis, should that level be maintained, would still carry an A rating.

Q. But, on the figure of $6,361,247 in 1941, had the 1942 proposed rates been applied, they would have lost that rating, is that true?

A. Yes, there would have been a very definite question about reducing the quality rating.

Q. Will you turn to Chart No. 44 and state what is shown on that chart?

A. Chart No. 44 of Exhibit No. 253, captioned, "Debt Coverage Ratios of Panhandle Eastern Pipe Line Company at Various Levels of Net Operating Revenue", here assuming a 6½ percent return on the $77,830,535 which is the total invested capital of the consolidated company, the net operating revenue, using the 1941 tax rates, would amount to $5,058,985. On the basis of such earnings, the fixed charges would be covered 5.72 times and the income available to par value of debt would [—] 15.21 percent.

Q. Slightly under the 16 percent?

[fol. 10249] A. That is slightly under the ideal figure of 16.

Q. What about the 1942 Morgenthau tax proposal?

A. Then, if you use the tax proposals as given by Secretary of the Treasury, Mr. Morgenthau, the net operating revenue would then be $3,541,749, on which basis of earnings the fixed charges would be covered 4.01 times and the income available to par value of debt would be 10.65 percent.

Q. That is well below the 16, isn't it?

A. Yes, that is very low.

Q. Where would that bond go in a rating on that basis?

A. I do not have any idea but it would certainly be considerably under A.

Q. All right. Now, turn to the right-hand portion of this Chart No. 44 and state what is shown thereon.

A. In the right-hand portion, I assumed a rate of 6½ percent of return on $66,935,894.

Q. Where did you get that figure?

A. That is invested capital. Mr. Dunn had made some calculations in a previous exhibit and I used that to find out the items that he had used in his calculations and applied the same principle as best I could to the consolidated company, and that showed an invested capital of $66,935,894. Then I assumed thereon the 6½ percent and, using the 1941 tax rates, the company would receive net oper-

ating revenue of $4,350,833 and, on such basis of earnings, [fol. 10250] the fixed charges would be covered 4.92 times and the income available to par value of debt would be 13.08 percent.

Q. Well below the 16?

A. Yes, well below.

Q. All right.

A. Then, following the same procedure but using the proposal of Mr. Morgenthau, the net operating revenue would then amount to $3,134,250 and, on such earnings, the fixed charges would be earned 3.54 times and the income available to par value of debt would be 9.42 percent.

Q. Well, what would happen to the rating of the bonds under those circumstances?

A. The decline there is such, I do not know. The point is that if the figures get too far out of line, there are points where we just do not rate the bond if it falls within that category.

Q. It becomes too highly speculative, is that what you mean?

A. That is right.

Q. It falls under the B class?

A. It would certainly be in the very lowest B class or in the C.

Q. May I ask if these two figures, $77,000,000-odd and $66,000,000-odd, which you have used in this Chart 44 are merely for illustrative purposes?

[fol. 10251] A. Yes, that is the only purpose of the calculations.

Q. You are not suggesting those particular dollar figures for any particular purpose, are you? A. No, sir.

Q. Now, will you turn to Chart No. 45 and state what that chart shows?

A. In Chart No. 45 of Exhibit No. 253, captioned, "Effect of Increased Gross Revenue and Taxes upon Panhandle's Net Operating Revenue", I show: in the first bar, the earnings reported on the consolidated basis as of the year ended February 28, 1942, in the amount of $6,361,247, which was based on the 1941 tax rates, and that figure comes from one of Mr. Watkins' exhibits and I have the page number noted in the table.

In the second figure is the one already presented, which gives effect to Mr. Morgenthau's proposal, in which case the net operating revenue would then be $4,526,618.

Then, in the next three bars, I made assumptions of increases in gross and used figures determined in this fashion: The first bar, that is, the first one on the chart, I assumed an increase in gross revenue of $1,154,390 which figure I arrived at by taking the average annual increase as experienced by Panhandle Eastern Pipe Line Company in the years 1937-1941.

Q. 1937 to 1941, inclusive?

A. Inclusive, yes.

[fol. 10252] Q. What did you show in that connection?

A. On that basis, the net operating revenue would be $4,088,030 and, on such basis of earnings, the fixed charges would be earned 5.30 times and the income available to par value of debt would be 14.10 percent.

Q. Well below the 16 which measures the ratings, is that true?

A. Yes, that is correct.

In the fourth bar, I assumed an increase in gross of $3,438,088—

Q. (Interposing) Pardon me; you mean an increase in gross revenue, do you not?

A. When I say "gross" that is what I mean, "gross revenue".

Q. During the year 1942, is that correct?

A. That is correct.

Q. Go ahead.

A. I assumed an increase in gross revenue of $3,438,088 and that assumed figure was the actual increase that took place in the gross revenue of Panhandle Eastern Pipe Line Company from 1939 to 1941 and, on that increased gross revenue, still applying Mr. Morgenthau's tax proposal—.

Mr. Littman: (Interposing) Pardon me. Is this increase in gross revenue attributable to regulated or unregulated business of Panhandle Eastern?

[fol. 10253] The Witness: Well, what I have assumed is a total over-all dollar figure by which the gross revenue increased with no regard as to breakdown of the gross revenue.

By Mr. Wheat:

* * * * * * * *

Q. Let's go on. What does this show?

A. On that basis, this would show that the net operating revenue would amount to $4,936,510 and, on such earnings, the fixed charges would be earned 5.58 times and the income available to par value of debt would be 14.84 percent.

Q. Still well below the 16, isn't it?

A. Yes, it is below the 16.

Q. All right. Now, what is your next to the last bar in Chart No. 45?

A. In the next to the last bar, I have assumed an increase in gross revenue of $5,771,948 which was the actual [fol. 1625] increase shown in Panhandle Eastern Pipe Line Company from 1937 to the end of 1941.

Q. Five full years?

A. Five full years; and applying again the tax proposal of the Secretary of Treasury, Mr. Morgenthau, the net operating revenue would be $5,190,437 and, on the basis of these earnings, the fixed charges would be covered 5.87 times and the income available to par value of debt would be 15.61 percent.

Q. Still under the 16?

A. Still under the 16. Then, in the last column, I merely repeat the figure that I had already given in Chart No. 26 of $5,382,677, which is the amount which I say is the minimum that is necessary to maintain credit position.

Q. What are the figures resulting from that? I think you have given them before, have you not?

A. I have given them before. The fixed charges would be earned 6.09 times and the income available to par value of debt would be 16.19 percent.

Q. Just over the 16 percent on the ideal basis?

A. That is correct.

Q. Now, Mr. Coffman, there is not anything magic, is there, about these three particular bars showing the various increases? You might just as well have taken $1,000,000, $2,000,000, $3,000,000, $4,000,000, or $5,000,000, might you not, to show your illustrations?

[fol. 10255] A. Yes, that is correct. I just selected a basis where I could use actual figures as against taking a round figure out of the air.

Q. And even when you assume an increase in gross revenue, the total increase over the past five years, you were still under the minimum which you testified was necessary to maintain credit position?

A. That is, applying Secretary of Treasury, Mr. Morgenthau's tax proposal, yes.

Mr. Littman: I would like to ask a question for clarification.

Mr. Coffman, what operating expenses do you assume in connection with your assumed increase of operating revenue?

The Witness: I took the percentage relationship of cost on the consolidated basis, that is, the February 28, 1942, figures, and I assumed that the relationship existent then of operating cost to that gross would be the same percentage that would apply against the increase here. In other words, if the operating expenses were 40 percent of gross, then I applied 40 percent of the increase to get the cost calculations to arrive at net operating revenue.

Mr. Littman: Do you show those details anywhere in your exhibit?

The Witness: Yes, table to Chart No. 45 will give you the detailed figures.

* * * * * * * *

[fol. 10256] Mr. Littman: Have you assumed any increase in investment would be necessary to produce this increase in gross revenue?

The Witness: No, I did not.

Mr. Littman: Does it make any difference, for the purposes of calculation, to what classes of customers this gas is sold, for purposes of your study?

The Witness: Well, for purpose of this study, it won't because I assumed a lump dollar amount added to the Feb-

ruary 28, 1942, figure, and then I have applied the percent of cost to that, so there was no need for talking about classes of service.

* * * * * * * *

By Mr. Wheat:

Q. Mr. Coffman, will you now turn to your Chart No. 46 and tell us what is shown on that chart?

A. In Chart No. 46 of Exhibit No. 253, captioned, "Calculation to Show Rate of Return Necessary to Produce $5,382,677—Assuming Various Rate Bases", I am merely here showing statistically what I said yesterday when I began to testify, namely, that once I directly compute the minimum earnings necessary to maintain credit position of $5,382,677, if I can find out or be told what the rate base is, then I can determine what the rate of return should be to produce those minimum earnings necessary to maintain the credit position so that here, if 6½ percent rate of return is to be used, then the assumed base would have to be $82,810,415 in order to produce $5,382,677.

Now, I have just worked out figures at intervals down the line to show that the figures or rate base go down as the rate of return on this base goes up.

Q. That is necessarily true since they must be in inverse ratio, mustn't they?

A. That is correct.

Q. If you are going to have this particular minimum earnings to maintain the credit position?

A. That is correct.

Q. And this chart is self-explanatory, is it not?

A. I think it is self-explanatory because the figure which I have determined which is of importance for my study is the $5,382,677 which I think has been fully covered and the application of that figure to assume rate bases was merely for the purpose of illustration to show concretely what I said verbally yesterday.

* * * * * * * *

[fol. 10258] Recross Examination.

By Mr. Littman:

Q. Mr. Coffman, have you testified in any other proceedings since you were last on the witness stand here?

A. Yes, I believe I have. Well, the Philadelphia Transportation Company I am sure of. Do you mean before the Federal Power Commission.

Q. I mean any courts or commissions.

A. I testified in the case of the Philadelphia Transportation Company before the Public Utility Commission of Pennsylvania.

Q. On the subject of rate of return on the same material?

A. I do not recall just when I was down here last—how many months ago has it been?

Q. My recollection is that you left the witness stand on the 3rd or 4th of January.

Mr. Wheat: That is right. It was just when the new deal was coming in with respect to this financing, was it not?

[fol. 10259] Mr. Littman: That is right.

The Witness: That is the only one.

By Mr. Littman:

Q. How about the Carolina Power & Light Company proceeding before this Commission?

A. Yes; I believe that was before, wasn't it? Wasn't that before February?

Q. No, it was since.

A. Just a moment, let me check my memory—all right, it was just after. I did appear in the Carolina Power & Light Company proceeding before this Commission.

Q. Have you ever testified before on the subject of rate of return before this Commission or any other commission or court?

A. No, I do not believe so.

Q. Do you know how much common stock of any of the six natural gas companies referred to in your Chart No. 21 is sold on the market?

A. You mean just the volume?

Q. That is right.

A. Well, I would want to check that. I could not answer just now.

Q. You made no study of that?

A. Well, as to volume, what I have gotten in the market [fol. 10260] quotations. I have not listed volume in any case in any of these exhibits.

Q. You are not prepared at this time to state whether the markets are thin or otherwise?

A. No, the question here is one of market quotations.

Q. Whether it be for one share of stock or 100,000 shares of stock?

A. Except I am considering the average of the high and low price over a period of time, not on any single day, so it is hardly one single share if any shares were traded at all.

Q. So far as you know, the market for the common stocks of these six natural gas companies may be even thinner than was the market for the common stock of Carolina Power & Light Company in 1925?

A. I cannot answer that question.

Q. Then, so far as you know, it might be?

A. Well, it could be anything. If I do not know, I presume is could be anything.

Q. Well, if the market were thinner than that which I just described for the Carolina Power and Light Company in 1925, would they be reliable?

A. Well, when you are talking about market quotations and several shares change hands between a willing buyer and a willing seller, it is indicative of a price, certainly.

Q. As a matter of fact, you disregarded market quo- [fol. 10261] tations on the common stock in the Carolina Power & Light proceeding before this Commission, did you not, because of the fact the market was so thin?

A. As a matter of fact, Mr. Littman, if you want to ask me some questions, I would like to go over and see just exactly what I did say and what the figures are on Carolina Power & Light. I do not mind being interrogated but I would like to freshen my memory if I am going to be interrogated on it.

Mr. Wheat: If you do not remember, you are at perfect liberty to say so now, and then freshen your memory.

The Witness: That study was exactly like this, so far as volume was concerned, and I would certainly hate to be put to the test of relying on my memory as to this figure or that figure without having a chance to refer to it.

By Mr. Littman:

Q. You do not mean you submitted the same kind of a study in the Carolina case that you did here, do you?

A. I said as to volume, I think, talking about the quantity of work that was done.

Q. You mean volume of pages in the exhibits or volume of what?

A. Volume of work that was done.

Q. You would not want to rely upon the quotations of common stock in a thin market for any purpose, would you, Mr. Coffman?

[fol. 10262] A. So far as getting the investors' appraisal over a large group of companies, I would have no question about that. On a single company, if there was just one share, it would depend then on what you were talking about. I would say that the one-share transaction indicated the price that was necessary between the buyer and the seller for the one share. Now, what effect a great block of stock on the market might have is another question, as to what that price would be, so that questions of valuation on the one hand are entirely different than the questions that you have here.

Q. There are more data available with respect to electric companies than there are with respect to natural gas companies, isn't that a fact?

A. You mean there are more electric operating utility companies?

Q. Yes, and more information, more reliable market prices?

A. Generally, I would say that was true.

Q. But you disregard the market in the Carolina proceeding, didn't you?

A. In the case of the Carolina proceeding, I determined what I believed to be the fair market value of stock on a particular date.

Q. Was that more than twice as much as the market value?

A. I am sorry, I cannot remember that. I still say if [fol. 10263] you want to interrogate me on this, either produce the copies of the exhibits on this or let me send to New York and get them.

Q. You just testified there not more than 60 days ago.

A. That is right, and I am just like you told me you were at the recess, Mr. Littman, when you quit a case you forget it and go on to something new.

* * * * * * * *

Q. Have you made any effort to determine the volume of sales of Panhandle Eastern Pipe Line Company's common stock on the market?

A. Yes, I think I have some figures on that someplace along. I think I could get them again. I do not remember what they were, but, over a period of some five years or a little longer, as I remember it, there was quite substantial trading.

Q. When was that?

A. I mean over the last five years, I will say about over the last five years up to the time I testified before.

[fol. 10264] Q. Was it as substantial as the Carolina Power & Light trading in 1925?

A. There again I do not recall what the trading was on Carolina Power & Light in 1925.

Q. As a matter of fact, when only something like 5 per cent or less of the common stock is being traded on the market, it is your opinion that the market price derived from those sales cannot be relied upon for any purpose?

A. Well, I think that we are getting somewhat confused on one issue. In this particular study I have made, I have made an analysis of all the companies that were available, which gives you, I would say, a reliable check.

Now, if you can come down to a particular company and a particular day, there is some question about that. You may find it necessary, depending upon the problem that is before [your] and particularly if it is a valuation problem, to look at other aspects of the price besides the market price.

Q. Are you saying that if you have unreliable data for six companies, you can add them up and divide by six and get something that is reliable?

A. I would say that it would have to be demonstrated that the data were unreliable for the six companies.

Q. You do not know right now whether these data for these six natural gas companies, to wit, El Paso Natural Gas Company, Interstate Natural Gas Company, Memphis Natural Gas Company, Southern Natural Gas Company, [fol. 10265] Panhandle Eastern Pipe Line Company, and Northern Natural Gas Company, are reliable, do you, because you do not know what kind of a market there is with respect to their common stock?

A. No; the basis of the calculations that I made here was taking all companies upon which I could secure market quotations from reliable sources.

Mr. Wheat: May I ask a question there, if I may interrupt a minute?

You included, did you not, in your study, the very large sale of common stock by Northern Natural Gas Company to the public?

The Witness: I included that one, yes, in Exhibit No. 65.

By Mr. Littman:

Q. That was the time the stock was issued?

A. Well, it was the sale of a large block of common stock which was as good a test as any we have as to what the investor thinks of a particular security.

Q. Suppose you describe the market of Southern Natural Gas Company common stock.

A. What do you mean by "describe"? Do you want to know the number of shares over the last five years, the daily trading, monthly, or what?

Q. Give us any of those that you mentioned.

A. Well, as I have told you, I did not use them, so I [fol. 10266] do not have them. If you want the tabulations, I will prepare them for you.

Q. Didn't you make any study of that feature at all?

A. None whatsoever in this study. I have stated very clearly in the record, I believe, that I took every security upon which there was a reliable market quotation and used it. If there were no such figures, I did not include the company.

Q. How do you know whether it is reliable or not without first ascertaining the volume of the market?

A. I am talking about a reliable source.

Q. You testified in the Carolina Power & Light Company proceeding that a thin market was unreliable, didn't you?

A. For a single company, and I say that right here.

Q. Suppose it is unreliable for six single companies. Can you add them up and divide by six and get any more reliable information than the reliability of any one of those six companies?

A. We do not want to get too many issues confused here. At this point—

Q. (Interposing) I am not getting confused.

A. I think you are, very definitely. We have been talking about all the over-all risks of capital and, in that, I was taking into consideration bonds, preferred stocks, and common stocks. A good many of the bonds and a good many shares of the preferred stocks are outstanding in the [fol. 10267] hands of the public.

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[fol. 10270] Paul B. Coffman a witness, having been previously sworn, resumed the stand and testified further as follows:

Recross Examination (Continued)

By Mr. Littman:

Q. Mr. Coffman, you were going to report this morning with respect to the Natural Gas Pipeline Company of America notes that were issued in 1941. Are you prepared to give us the information?

A. I have some information on the subject. The notes were serial notes, $1\frac{3}{4}$ per cent, 8 years, on a semiannual basis and they were secured, I think, with the first mortgage bonds on the property. At least, for all practical purposes, they were a very highly secured note and carried the rate of $1\frac{3}{4}$ per cent.

Q. What was the principal amount of these securities?

A. $17,500,000.

Q. Mr. Coffman, in connection with yesterday's cross-examination, you wanted to have me refer to your statement in the Carolina Power & Light Company proceeding

that dealt with the market of the common stock of that company. I hand you a copy of Exhibit No. 307 in that pro- [fol. 10271] ceeding entitled "Study Relative to Valuation of Common Stock of Carolina Power & Light Company (Old) as of April 6, 1926", and refer you to the text opposite Chart No. 6, a paragraph, which I shall read:

"It is obvious from this review of the market action of the common stock of Carolina Power & Light Company this year preceding the date of valuation that the market was an extremely thin affair with wide fluctuation occurring on only a small number of shares traded. In view of the thinness of the market and the fact that no quotations were available subsequent to December, 1925, I considered it necessary to approach the determination of a fair market value of the common stock of the Carolina Power & Light Company as of April 6, 1926, on the basis of earning power."

Have I correctly read from your exhibit?

A. Yes, you have.

Q. Mr. Coffman, you have submitted Exhibit No. 253 in this proceeding which exhibit is entitled, "Study Relative to Minimum Return Requirements of Panhandle Eastern Pipe Line Company (Giving Effect to Property Acquisitions)". Is this exhibit the same character of study as the one which you previously submitted in this proceeding as Exhibit No. 65?

A. So far as the earnings requirements are concerned, it is the same with the exception, as I explained in direct [fol. 10272] examination, I had added certain additional figures for earlier years and for the full year 1941. Also, I think I said that one difference is that in the time that I had to work upon this material, I did not find time to continue to deal with those figures which were considered in Exhibit No. 65 which led to an item which I captioned, "Total dollars needed". Otherwise, I would say that the two studies are identical.

Q. Your Study which is identified as Exhibit No. 65 bore the title, "Study Relative to Rate of Return on Panhandle Eastern Pipe Line Company", whereas your new exhibit, No. 253, is entitled, "Study Relative to Minimum

Return Requirements for Panhandle Eastern Pipe Line Company".

I wonder if there is any significance in the fact that you have changed the title of your new exhibit?

A. I would not attach any significance to it. The fact is that, in Exhibit No. 65, the important figure, from my standpoint, was the so-called "end" figure, that is, the capital requirements figure which I referred to yesterday in Exhibit 65 on Chart No. 37 and that end figure was the one that I was trying to determine again as of February 28, 1942, taking into consideration the changed status of the company and showing the consolidated results.

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By Mr. Littman:

[fol. 10273] Q. Were you referring to the end figure in Chart No. 37 of Exhibit No. 65 in the amount of $5,064,821 to which you refer in that chart, as "a fair return to investors" and "current capital requirements"?

A. That is correct.

Q. Am I correct in understanding that in Exhibit No. 253, your Chart No. 25 entitled, "Minimum Earnings Required to Maintain Credit Position of Panhandle Eastern Pipe Line Company" contains the same character of study in so far as the "current capital requirements" are concerned, sometimes called by you "a fair return to investors"?

A. That figure is the same.

Q. When you said "the figure is the same", you did not mean the dollar amounts were the same but that the figure was of the same character?

A. That is correct.

Q. In view of your testimony it would be proper, would it not, to refer to the figure of $5,325,677 which appears in Chart No. 25 of Exhibit No. 253 as "a fair return to investors"?

A. That is not exactly correct, as I outlined yesterday, because of the fact that I believe in this case, since the preferred stock facts are out, that evidence must be taken into consideration and, therefore, it seems to me that the [fol. 10274] figure shown in Chart No. 26, which is $5,382,677, is the proper figure.

Q. Well, is the $5,382,677 figure one which could properly be labeled "a fair return to investors"?

A. I would say that that was correct.

Q. Now, the figure in Chart No. 25 in the amount of $5,325,677 reflects, does it not, the actual present earnings requirement of the outstanding bonds and preferred stock of Panhandle Eastern?

A. Yes, that is correct.

Q. The reason you refer to the larger figure as the proper figure is because of the circumstances surrounding the sale of the preferred stock by the underwriters within recent weeks, is that correct?

A. Generally, that is correct. The point that I was making in regard to the preferred stock was that in the experience of the sale of the preferred stocks since February 4, it would rather prove to me that perhaps the original offering price was not quite in tune with the investors' appraisal. Therefore, investors have not purchased it. If that is true, then to get at a more accurate appraisal, it seems to me those facts must be taken into consideration and, therefore, I would use the 6.23 per cent as applied against the preferred stock instead of the 5.87 per cent.

Q. You label both figures "earnings required to maintain [fol. 10275] tain credit position", do you not?

A. Yes, I do.

Q. Is it correct to say that the amount of $5,325,677 which appears in Chart No. 25 represents, in truth and in fact, the earnings required to maintain the credit position of Panhandle Eastern Pipe Line Company and subsidiary companies as of February 28, 1942?

A. Based upon their actual experience at the time, that is correct. My point still remains, however, that looking at this matter from the investors' point of view, the 6.23 per cent has significance, particularly if further financing or need for financing should arise.

Q. Which one of the three figures, namely, $5,325,677 related to invested capital as of February 28, 1942, $5,382,677 related to invested capital as of February 28, 1942, and $5,064,821 related to invested capital as of June 30, 1941, is the amount required to attract capital?

A. Well, the answer to that can be only one, it seems to me—$5,382,677.

Q. That represents what percentage of the invested capital of Panhandle Eastern Pipe Line Company and subsidiary companies, including Michigan Gas, as of February 28, 1942, in the amount of $77,830,535?

Mr. Wheat: May I suggest, Mr. Littman, that is shown on Chart No. 46?

[fol. 10276] Mr. Littman: It is also shown on the table supporting Chart No. 25, I believe.

The Witness: 6.92 per cent.

By Mr. Littman:

Q. In other words, Mr. Coffman, as I understand your Chart No. 26 of Exhibit No. 253, the return required to attract capital to the enterprise as of February 28, 1942, is 6.92 per cent?

A. I think the better way to say it is that the amount that is needed is the $5,382,677. If you are going to use the rate base which you have mentioned of $77,830,535, all right. If there is going to be some other figure, as shown in the last chart, No. 46, why, the percentage would be different.

Q. Now, Mr. Coffman, in truth and in fact, Panhandle Eastern attracted the invested capital as of February 28, 1942, on an actual basis with a 6.84 per cent return, did it not, overall, as shown by your Chart No. 25?

A. That is correct because, as I have explained in Chart No. 25, I have applied the actual rate on the preferred stock but, when you consider the market, the actual market, weight must be given to the fact that this preferred stock really has not sold on the basis originally offered.

Q. And that would simply raise the per cent, according to your theory, to 6.92 per cent?

[fol. 10277] A. That is correct, based upon the $77,830,535.

Q. In other words, it would require a return of 6.92 cents per annum for each dollar of capital required, according to Chart No. 26 of Exhibit No. 253?

A. That is correct.

Q. Is my understanding correct, Mr. Coffman, that when you last testified here the comparable percentage which you stated was necessary for the attraction of capital was 7.99 per cent as shown in your table for Chart No. 26 in Exhibit No. 65?

A. Yes, that is correct.

Mr. Culton: That was on the old Panhandle Eastern Pipe Line Company alone at that time, was it not?

The Witness: Yes, Exhibit No. 65 is based altogether on the old Panhandle Eastern.

By Mr. Littman:

Q. Mr. Coffman, I want you to again refer to Chart No. 25 in Exhibit No. 253 where you show the actual return required to maintain credit position in the amount of \$5,325,677. Now, when you previously testified here, the comparable amount which you there labeled, "fair return to investors" was \$5,077,648 as shown in your Chart No. 26 of Exhibit No. 65, is that correct?

A. That is correct.

Q. The additional capital requirements or return re- [fol. 10278] quired after the acquisition of Michigan Gas and the other properties acquired by the recent transaction in February of 1942 is represented by the difference between those figures, to-wit, \$248,029, is that right?

A. Yes, the difference is \$248,029.

Q. How much new capital was attracted by the financing in February of 1942? To shorten the matter, it is my understanding that it would be the difference between the \$77,830,535 of invested capital per your Chart No. 25 in Exhibit No. 253—

Mr. Wheat: I think, Mr. Littman, that is not quite correct because the common stock amount in Chart No. 26 of Exhibit No. 65 and the common stock and surplus amount in Chart No. 25 in Exhibit No. 253 are not quite alike. Possibly you overlooked that. What you are getting at is the difference between the preferred stock and bond amounts, isn't it? When you said, "how much capital was attracted" by the financial transactions, I just thought possibly you had overlooked that common stock difference there.

Mr. Littman: The figure I wanted, Mr. Wheat, was the difference between the invested capital as of June 30, 1941, and as of February 28, 1942.

Mr. Wheat: Yes, that is quite different. Thank you.

Mr. Littman: That is, as Mr. Coffman has defined the term "invested capital".

[fol. 10279] Trial Examiner: Your question was interrupted, Mr. Coffman. Do you understand what was desired?

The Witness: As I understand the question, Mr. Littman would like to know the amount of difference between the invested capital as of June 30, 1941, and the invested capital as of February 28, 1942, and that difference would be $14,305,000, approximately.

By Mr. Littman:

Q. In other words, you have got $14,304,696 more of invested capital as of February 28, 1942, than you had as of June 30, 1941. Is that correct?

A. Yes, that is correct.

Q. The additional capital requirements or return required to finance that additional amount of invested capital is how much, expressed in terms of per cent? We get 1.7 per cent. Does that check?

A. That is just about correct.

Q. Is that about right? A. Yes, sir.

Q. Mr. Coffman, I want you to assume, and we must necessarily make this assumption because we do not know what the rate base is going to be, that for each $1,000,000 of invested capital, $990,000 is allocable to regulated business and $10,000 is allocable to unregulated business. In other words, 99 per cent of the invested capital is properly [fol. 10280] allocable to regulated business and one per cent is properly allocable to unregulated business. Do you understand me so far? A. Yes.

Q. I want you to further assume that the unregulated portion of the business earns a modest return of at least 100 per cent per year or $10,000. What annual return would investors require on the regulated portion of the business in order to get an over-all annual return of 6.84 per cent on its invested capital or a return of $68,400, expressed in dollars?

A. Well, it would take me a few minutes to work that out but I might say—

Q. (Interposing) Won't the answer be, and I think you can very quickly follow my arithmetic, the over-all return of 6.84 per cent on $1,000,000 of invested capital is, of course, $68,400, isn't it, Mr. Coffman?

A. That is correct.

Q. Now, one portion, to wit, the unregulated portion, is earning $10,000 so you deduct that amount from the $68,400 to get the amount of $58,400 which is applicable or allocable to the regulated business, do you not?

A. That is correct.

Q. And that represents 5.8 per cent of the regulated business, does it not, by way of return, that is, of the [fol. 10281] investment in the regulated business. Is my arithmetic correct?

A. That arithmetic is correct but I still have some difficulty with the illustration you give because, so far as the investor is concerned and this return is concerned, he is not breaking the matter down between regulated and unregulated business.

Q. Let me make it clear upon the record.

The effect of my calculation which you have checked is, if 99 per cent of $1,000,000 of invested capital is properly allocable to the regulated portion of the business and one per cent is properly allocable to the unregulated portion of the business and if the unregulated portion of the business is earning a return of 100 per cent per year then, assuming a necessary over-all fair rate of return of 6.84 per cent, the division in per cent of return, as between the regulated and unregulated portions of the business would be, mathematically, 5.8 per cent return of the regulated portion of the business in order to produce the over-all return of 6.84 per cent. Is that a correct summary?

A. Yes, using the hypothesis you gave, the arithmetic is as you have stated but I still say there are some further angles to it that should be considered.

Q. In other words, if the unregulated portion of the business produces a very high return, the investor would [fol. 10282] require a correspondingly low return on the regulated portion, wouldn't he, because he is interested, as you say, in the total over-all return?

A. He is interested in the total over-all return and he has no way to break the figure down as to component parts so that, so far as allocation is concerned, which you are talking about, it really does not affect him directly.

Q. Well, carrying the example further, so far as the investor is concerned, if the unregulated portion of the

business is enjoying so high a return as to make the over all return satisfactory to him, then the investor does not care how much is being earned by the regulated portion at all, does he?

A. Well, it is true that the investor is looking for return for the investment he has in the business. Now, I think it is also true, if he saw an investment in which a large portion of it were of a peculiar type, then he would give some consideration to his over-all return. What he will try to do, in looking at the company, to the best of his ability, is to see what the components of earnings are. He may not be able to refine it too much but, after knowing that, he will depend upon what he believes to be a required return without attempting mathematically to work each individual component out.

Q. You have not undertaken to make such a breakdown [fol. 10283] as between regulated and unregulated portions of the invested capital here, have you?

A. No, I have not.

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By Mr. Littman:

Q. Assume that a natural gas pipe line company is selling gas to war industries at an annual profit of at least 100 per cent of its investment dedicated and allo [fol. 10284] cated to that business, would the investors be wary of such a company in view of present conditions?

A. I think I have made it pretty clear, Mr. Littman, right along that investors, to the best of their ability, will analyze all factors having a bearing upon the security and obviously, if they thought a business, that is, a company was engaged in a business which, although profitable at the moment might some place along the line discontinue because of the peculiar nature of the business, they would give that weight.

Q. And, therefore, they would require a higher rate of return than otherwise, wouldn't they?

A. They would require a higher rate of return.

Q. And, of course, if such a situation were present, it would unduly inflate the indicated over-all return?

A. It would. In so far as it was a proportionate part of total, it would have an influence to that proportionate extent.

Q. You have, in this new exhibit, undertaken to show the effect of Mr. Morgenthau's proposed tax law upon this company's operation but before taking up the subject of Mr. Morgenthau's proposal, I would like to ask whether you have or have not abandoned your opinion on the subject of amortization which are shown in your Exhibit No. 65 but which do not appear in your new Exhibit No. 253?

[fol. 10285] A. There is only one question and that is about that word "abandoned". I have not abandoned the matter as one of approach. The fact is in this particular study, Exhibit No. 253, I have not included any study on amortization because that item, along with operating expenses and so on, were determined prior to this earnings required to maintain credit position figure which is the only one which has been included in this study. I mean just because it is not included in this study you are not pinning me down to the statement I have abandoned an idea I had at one time but I still am willing to talk about amortization.

Q. Mr. Coffman, I want to be altogether fair about the matter. In other words, the mere fact that you do not include an amortization study in your new exhibit should not be taken or construed as any indication that you are abandoning your contentions with respect to amortization, is that right?

A. Yes, that is correct.

Q. Now, if you had had the time, as I understand your testimony, you would have made a similar study here, would you not?

A. Yes, I could if I had the time.

Q. In other words, you would still divide the total investment by 25 years, or 24 years to determine the annual amortization requirement, wouldn't you?

[fol. 10286] A. Well, I would not want to answer that question just at the moment until I had more time to see from that particular item the over-all picture on the consolidated basis as against Panhandle Eastern alone but, so far as the principle was concerned, I would continue that.

Q. And you, so far as the principle is concerned, still amortize cash in bank?

A. As long as it was invested capital and in the business, I contend and believe that the investor wants a return upon that just as well as other invested funds.

Q. I am not talking about return. I am talking about amortization, that is, the amortization of the investment or invested capital.

A. Well, I do not know as I can answer. If I were to work the problem out again obviously, if I thought I had made some error in my previous calculations, I should correct it. I have not made the calculations for the moment and I cannot give you a specific answer.

Q. You do not consider your previous amortization theories in error, do you?

A. Well, to date I have had no reason to.

Q. And you did amortize, as your previous exhibit shows, cash in the bank?

A. That is correct.

Q. And working capital?

[fol. 10287] A. That is correct.

Q. And any write-ups, if any existed and were present in the amount of invested capital?

A. We amortized the invested capital as defined in that study.

Q. Which definition is simply the addition or total of the outstanding amount of bonds, preferred stock, common stock and surplus?

A. That is correct.

Q. Now, we will take up your treatment with respect to Mr. Morgenthau's proposed taxes.

You secured most of your book figures for purposes of your new study and I refer particularly to Chart No. 45 in Exhibit No. 253, from certain of Mr. Watkin's exhibits?

A. Yes, sir, that is correct.

Q. And that same situation is true with respect to Chart No. 43 of Exhibit No. 253?

Mr. Wheat: Which chart?

Mr. Littman: Chart No. 43 of Exhibit No. 253.

May we have an understanding that, unless designated, the chart numbers to which I refer, unless otherwise stated, will be the charts in Exhibit No. 253?

[fol. 10288] The Witness: Do I have a question pending?

(Whereupon, the pending question was read by the reporter.)

The Witness: Yes, that is correct also.

By Mr. Littman:

Q. I hand you a copy of Mr. Watkins' Exhibit No. 199 and ask you to state the net income shown on that exhibit in the consolidated column, pro forma, for the twelve months ended February 28, 1942, as adjusted to give effect to Federal income and Federal excess profits tax rates proposed in recommendation of Secretary of Treasury Morgenthau.

A. The net income reported in that exhibit is $3,710,634.26.

Mr. Wheat: Pardon me, Mr. Littman, you are referring to the net income on Exhibit No. 199, are you?

Mr. Littman: Yes.

Mr. Wheat: And not the net operating revenue?

Mr. Littman: Yes.

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By Mr. Littman:

Q. Now, referring to Chart No. 43 of your new exhibit, you show net operating revenue for the twelve months [fol. 10289] ended February 28, 1942, based on Mr. Morgenthau's tax proposal in the amount of $4,526,619. Now, that is the net operating revenue as distinguished from net operating income in the smaller amount which you just read, is it not?

A. It is the net operating revenue as distinguished from the net income figure.

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By Mr. Littman:

Q. Now, we will confine our discussion to net income for the moment, Mr. Coffman, as distinguished from net operating revenue. Of course, in your opinion, Mr. Coffman, both of the figures are reliable for our use here, are they not, as shown by Mr. Watkins' exhibit?

A. I believe so.

Q. Will you please turn to Mr. Watkins' Exhibit No. 198 and read into the record the net income, consolidated, as there shown for the twelve months ended February 28, 1942, which I believe reflects the 1941 actual tax rate?

A. Do you want the net income?

Q. Yes, the one at the very bottom of the exhibit.

A. That figure in Exhibit No. 198 is in the amount of $5,546,261.94. That is net income.

Q. Now, the effect of Mr. Morgenthau's tax proposal, according to the figures which you have just read, will be to [fol. 10290] reduce the net income by 33.1 per cent, isn't that correct?

A. That is approximately correct.

Q. Obviously, this new tax proposal is not directed solely at Panhandle Eastern Pipe Line Company but applies to all pipe line companies as well, does it not?

A. That is correct.

Q. Now, let's look at some of the other natural gas pipe line companies which are shown in your Chart No. 21. There you show earnings-price ratios of natural gas pipe line company stocks for the year 1941 for El Paso Natural Gas Company, Interstate Natural Gas Company, Memphis Natural Gas Company, Northern Natural Gas Company and Southern Natural Gas Company, do you not? A. Yes, I do.

Q. Now, those companies are comparable, in your opinion, to Panhandle Eastern Pipe Line Company, generally?

A. Well, the matter of comparability is a little bit tough but they are pipe line companies, I will say that. They are in the same industry, conducting about the same kind of business.

Q. They are of sufficient comparability, in your opinion, are they not, to warrant their placement on this chart in close juxtaposition to each other for comparative purposes in so far as earnings-price ratios are concerned, are they not?

[fol. 10291] A. What I was doing was showing what was happening to all the companies in the industry. That is what the investor does, he looks at the industry and all the information he can get on the industry.

Q. Well, the effect of the Morgenthau tax proposal will be approximately the same on these natural gas pipe line companies as on Panhandle Eastern, will it not, generally?

A. Well, it will depend upon their taxable income positions. Obviously, in so far as, let us say, all these companies were in the same tax brackets, excess profits tax rates and so on, the effect would be about the same but, if they are in a different bracket, dollar-wise, obviously there will be considerable differences.

Q. What you mean to say is if Panhandle Eastern is earning more excess profits than the other companies, it will have to pay more taxes under Mr. Morgenthau's proposal than the other companies?

A. It has been stated in the record that this company is already in a certain tax bracket. If that tax bracket is different from some other company, naturally there will be a difference in the rate applied and in the dollars paid.

Q. I believe you said that certain differences applicable to individual companies would wash out if you considered them altogether, as a general theory. Is that correct?

A. I made that general application in regard to one point.

[fol. 10292] Q. Well, can we agree, as a general proposition, that the Morgenthau tax proposal will affect these six natural gas pipe line companies in more or less the same fashion?

A. Well, I am perfectly willing to say it will affect them but, until I have made calculations to know that the result was 33 per cent in each individual case, I would not go that far in my answer.

Q. You have not made a study to determine the precise effect on each of these natural gas pipe line companies?

A. Except dollar-wise, as I have shown, Mr. Littman, I did not go ahead and make a percentage calculation to see how much difference it means here and how much difference there, as you are now discussing the question.

Q. Let's assume for purposes of our discussion that the Morgenthau tax proposal will affect these six pipe line companies equally.

Now, please turn to your table supporting your Chart No. 21. There you show that the earnings available for

common stocks, that is, the net income for these six natural gas pipe line companies for the year 1941 totaled $13,921,893. Is that correct?

A. That is correct.

Q. And from that figure, you made a determination of earnings-price ratio by applying those earnings to the aggregate market price of common stocks in the amount [fol. 10293] of $116,241,981 and you secured the weighted average earnings-price ratios for those companies of 11.98 per cent. Is that general characterization correct?

A. That is correct.

Q. Now, if the Morgenthau tax law were to affect these six companies in like fashion, the 1941 net earnings of those companies in the amount of $13,921,893 would be reduced by 33.1 per cent, is that correct?

A. That is correct.

Q. Will you please give us the resulting earnings available for common stocks of those companies on that basis?

A. It would be approximately $9,281,262.

Q. That is close enough for our purposes.

A. I took 33⅓ per cent instead of 33.1 per cent.

Q. Now, will you use those earnings available for common stocks in the amount that you have just read and apply it to the aggregate market value of common stocks and tell us what the weighted average indicated earnings-price ratio is for these companies, giving effect to the Morgenthau tax proposal?

* * * * * * *

The Witness: It would just be approximately 8 per cent.

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[fol. 10294] Q. That checks close to our figure. It is your opinion, is it not, Mr. Coffman, that the investor is more interested, in fact much more interested, in the projected earnings of a company than in historical earnings?

A. The investor, if he is contemplating the purchase of a security where it is particularly an industrial security, is interested in what he thinks the earning capacity of the corporation is. He will try to determine that by its past record and then will make a calculation as to what he can expect if he should happen to make his investment in the

company. In other words, all past earnings have already been taken by some other person so that when he makes his investment, he is chiefly interested, so far as earnings are concerned, in the earnings to come.

Q. The informed investor would got through somewhat the same general calculation as we have just gone through, would he not, to ascertain the effect of the Morgenthou tax proposal upon the coming year's business?

A. Yes, I think he would very definitely make calculations to see what the effect was going to be.

Q. And calculations probably similar to those which we have made here for testing purposes?

[fol. 10295] A. I should think so.

Q. By the way, Mr. Coffman, what per cent of return, in your opinion, is required by Panhandle Eastern common stockholders? Now, by per cent of return, I am talking about dividends and I have in mind your Chart No. 5.

A. I cannot give a specific figure. My statement in regard to both Exhibit No. 65 and Exhibit No. 253 was to this effect: That certainly, if a common stockholder believes that, as a return on his common stock investment, he will receive on the average only 3.48 per cent. I know that he will not supply any more money because he can do better than that in preferred stock and even in some bonds so that some earning has to be allowed which would enable this company to make a return to the common stockholder which will bring that average up quite a bit. I do not know what it is. I have made no calculations in regard to what the figure might be.

I merely stated that so long as this average remained around 3.48 per cent, it was a pretty tough situation, so far as common stockholders were concerned. They were perfectly willing, when they invested money, to wait in the lean years, as I think I stated before, but they made their investment in the hope that when this company got on its feet and had its markets established, earnings would be sufficient to permit a return which would compensate them for their risk.

Q. Now, the common stockholders received no dividends, [fol. 10296] according to this chart, through the year 1936, is that right?

A. I do not know. I would not want to say quite that, Mr. Littman, because the only company figures I have are

those in Mr. Watkins' exhibit and I believe they started as of April, 1932. In other words, there were nine months of 1932 and the remaining years.

Q. I had reference to that date. I did not intend to be technical about the date of the actual commencement of operations.

A. Yes. Then no dividends on common stock were paid from April of 1932 until January 1 of 1937.

Q. Then the dividends were 1.66 per cent in 1937; 7.27 per cent in 1938; 4.19 per cent in 1939; 8.62 per cent in 1940, and 7.32 per cent in 1941. Is that correct?

A. Yes, that is correct.

Q. An over-all average for the 9¾ years of 3.48 per cent of dividends on common stock?

A. Yes, that is correct.

Q. Now, you have told us that the earnings-price ratio for common stock should be 12 per cent, have you not?

A. Yes, I have.

Q. Are you able to advise us how much of that, in your opinion, will be necessary to make the common stockholders satisfied? Simply advise us what portion of this 12 per cent is truly applicable to the common stockholders by [fol. 10297] way of dividends and by way of surplus or haven't you made any such study?

A. I do not have calculations on that at the moment, Mr. Littman, because, as you know, the earnings-price ratio is talking about earnings whereas the ratio in Chart No. 5 is talking about dividends so, naturally, there are two different things to start with.

Now, the question comes down, so far as the dividends are concerned, as to what, in the management's opinion, can be paid by way of dividends on the common stock from one year to another. I mean I think the dividend payment is a managerial question. Estimates could be made on the matter. I just have not made them so I cannot answer your question right now as to what it is or should be.

Q. Well, you know that Panhandle Eastern was certainly able, if it had so desired, to pay more dividends, at least since 1937, since they actually paid, do you not?

A. Well, I do not know as I am prepared to say that. The Company has been expanding pretty rapidly. It is a question of whether the management feels that to protect

their position they should maintain their working capital position, as they did, or whether they would pay more of it out in dividends. I do not know as I would want to make the statement that you have just made.

Q. In other words, it was simply a matter of discretion with the company as to whether or not it wanted to pay its [fol. 10298] earnings out in dividends or apply a portion of them back into the business?

A. Yes, that is a matter of managerial policy. The management would have to decide that.

Q. Now, you have not seen any signs of these stockholders being dissatisfied with the returns on their common stocks which are shown historically on Chart No. 5, have you?

A. Well, that is a rather hard question to answer, Mr. Littman. I mean about the only way I know that you can tell whether a stockholder is dissatisfied is about on two counts. Either he just gets mad and sells his stock or he brings a lawsuit against the corporation to bring his bone of contention before the Court. He may form a stockholders' committee or something else to start a little agitation for this or that but, otherwise, I do not know how you can tell whether he is dissatisfied or not.

Q. Columbia Oil owns slightly more than 50 per cent of the common stock, does it not?

A. That is correct.

Q. You do not know of any efforts that have been made by Columbia Oil to voluntarily dispose of its common stock in Panhandle Eastern, do you?

A. I do not know of any, no.

Q. As a matter of fact, you know that certain gentlemen connected with Mo-Kan would be delighted to buy [fol. 10299] some of Columbia Oil's common stock, and pay a handsome premium. Don't you know that?

A. No, I really do not know that. I have heard gentlemen talk a lot of times but, if we are talking facts, I really do not know the facts.

. . . .

[fol. 10300] By Mr. Littman:

Q. Will you please turn to Chart No. 25, Exhibit 253; this chart shows that earnings of $5,325,677 are required to service the $77,830,535 of invested capital in Panhandle

Eastern and subsidiary companies as of February 28, 1942; is that correct?

A. Well, if we could use the terminology that I have used, it would be a little preferable to me. It is the amount of earnings required to maintain the credit position. "To service" is subject to some broad interpretations.

Q. Those are the requirements to maintain the credit position?

A. That is correct, not giving effect to the experience of the preferred stock sale.

Q. How much of this $77,830,535 represents net working capital?

A. Well, it is a little hard to answer your question just as you put it, because here we are talking about capital structure only. The most that I could say is that as of the date of the $77,830,535 the net working capital, including the amount received from the new financing was $6,576,743 which is shown on Chart No. 8 and which I have already explained has been committed to the estimated plant expenditures for the ten months from February 28 to December 31, 1942.

[fol. 10301] Q. Well, roughly, for every dollar of net working capital which is included in your invested capital, the earnings required are 6.84 cents?

The Witness: May I have that read, please?

* * * * * * * *

A. Well, the 6.84 percent, that is percent of earnings required on the total invested capital, or $6.84, as you wish to put it, is the amount that I have stated in Chart No. 25 and table supporting Chart No. 25 in Exhibit 253.

Q. Will you please tell me how much in dollars of earnings is required per your Chart No. 25 for the net working capital which is in the amount of $6,576,743?

A. I just don't know how you can do that, Mr. Littman. The total invested capital, as computed in Chart No. 25 includes the bonds, the preferred stock, common stock, and surplus, and that is the total amount of invested capital computing invested capital on that basis.

Now, at the time of that computation there was, in working capital, the figure that we have just mentioned of $6,576,743, but I haven't talked in terms of earnings per work

ing capital; I am talking in terms of securities that are held by the investors.

Q. You are providing, however, sufficient earnings to cover an invested capital which reflects six and a half mil- [fol. 10302] lion dollars of working capital; isn't that right?

A. The invested capital, as of February 28, 1942, does take into consideration the amount of working capital mentioned, that is true, but when the investor gets down to the particular security he holds, which is either a bond, a preferred stock, or a common stock, you can't talk about the earnings required on that particular section.

I can talk to you of the amount required on bonds, preferred stocks, and common stocks, but net working capital, in other words, is not sold as a security, and I can't tell you whether the working capital is so much in the bonds section and so much in the preferred section and so much in common stock. I don't believe anybody else can unless you liquidate the company, and then the bonds come first.

Q. Well, wouldn't it be fair to say that the six and a half million dollars of net working capital was distributed as among the common stock, preferred stock, and bonds, in the same general ratio as is indicated in your Chart No. 25?

A. Well, I wouldn't want to make that statement because if some catastrophe should happen today, for example, where the company was going to liquidate, as I say, ~~the bonds~~ would be paid off, first, and the first thing you use is cash which is working capital. If there wasn't enough cash to pay off the bonds, the ~~preferred~~ stockholders get nothing, and the common stockholders get [fol. 10303] nothing, so I don't know how you can distribute one way or another.

Q. I think we can perhaps avoid these difficulties you have raised by putting the question this way: Assuming that the company did not have this $6,576,000 working capital, what would its investment be as of February 28, 1942?

A. The total invested capital excluding the net working capital, would be $71,253,792.

Q. And what would be your earnings required, if that were the invested capital?

A. The earnings required then would be approximately $4,663,467.

Q. What is that again? A. $4,663,467.

Q. Now, that is how much less of earnings required than you show in your Chart No. 25? A. $689,210.

Q. Now, we are agreed, are we not, that $689,210 of your "earnings required to maintain credit position" is required by reason of a six and one-half million dollar amount of net working capital as of February 28, 1942; isn't that right?

A. Making the calculations on the basis I have done; that is correct.

[fol. 10304] Q. Now, if this Commission were to allow, let us say, one million dollars of working capital as compared with the figure of six and a half million dollars there would be a substantial reduction in earnings required to maintain credit position, wouldn't there?

A. On that basis, it would be about $569,210.

Q. Less than the earnings required shown in Chart No. 25 of $5,325,677?

A. That is correct.

Q. Now, please refer to our Chart No. 8.

Now, there you show that the estimated plant expenditures for the next ten months, February 28 to December 31, 1942, are $6,530,900; is that right?

A. Yes, that is.

Q. And am I correct in understanding your testimony yesterday that the large amount of net working capital on hand on February 28, 1942, was occasioned by reason of the company having on hand moneys which it had received through its financing program for the purpose largely of financing new capital additions; is that correct?

A. Yes, a portion of it. I have tried to show that in Chart No. 8 in Exhibit 253, showing the decline from June 30, 1941, of $4,661,875 to $3,507,683, as of December 31, 1941, and $2,951,908, as of February 28, 1942, so the difference between the $2,951,908, as of February 28, 1942, [fol. 10305] and the $6,576,743 was the amount realized from the financing in February, 1942, to the amount of $3,624,835.

Q. Well, in other words, your return expressed in dollars and called by you "earnings required to maintain credit position" contemplates the return necessary on this large amount of six and a half million dollars of net working capital?

A. Well, I don't think that is quite an accurate statement.

What I am trying to observe in these data is this: that between June 30, 1941, and February 28, 1942, a matter of about eight months, the working capital had declined almost 50 percent. That is excluding the new financing, which means that the working capital, as of June, must have been needed in corporate business for one purpose or another, so that it automatically declined, was used in the business.

Now, when you come to February 28, 1942, and you have the $6,576,743 of working capital, it is evident, if the estimated plant expenditures and the program that is laid out works out to the estimated figures, that the working capital, as of February 28, 1942, has already been spent, for all practical purposes, so the company really hasn't any working capital.

Where it is going to replenish that supply will be from earnings, and the point I am trying to make there is that [fol. 10306] working capital, as such, must be determined by the needs of the corporation so that if it is converted from liquid form to fixed form, or goes out in the way of an expenditure, then the item in itself does not tell you much of anything, you have got to look at these other facts, and I find from these other facts that what seemed to be high when we last discussed this was actually needed in the business over those remaining eight months after February 28.

Q. You mean actually needed for capital additions, for instance?

A. Might have been capital additions or maybe it was meeting the sinking fund requirements, any corporate purpose, paying of wages, salaries, and so forth.

Q. Isn't your testimony, Mr. Coffman, that a rate payer should pay a return on estimated plant expenditures before they are even installed and in service?

A. There I think you are using a coincidence to prove a fact. I mean it is true, as shown right here in Chart No. 8, that the estimated plant expenditures are approximately six and a half million dollars. Those are to be paid during the remaining ten months of the year. Net working capital at the time was six and a half million dollars. I am just saying to operate any business as a going firm, you necessarily have to have moneys in the till to do the things that are necessary to maintain and provide the [fol. 10307] service and keep this company going.

Q. Now, the effect of that method, however, used by you, is to give the company a return upon that portion of its net working capital, which is yet unexpended for capital additions which have not as yet, of course, been installed; isn't that the effect of your method?

A. Well, to me, a business is a combination of fixed assets and working assets, and it takes the combination of the two to make the wheels go around to produce and render the service. Now, if it is shown, as I think these facts clearly indicate, that the working capital of a certain figure at a moment of time is already to be needed to maintain and render the service by this company to the consuming public, then those dollars are working just as effectively for the consumer as the pipe line company.

Q. And under your theory of rate making, the rate payer should pay a return upon those dollars before they are even converted to property in service?

A. As I stated, in connection with Exhibit 63—and I think it holds true here—people have just recently put in \$15,000,000 or approximately that—in the plant through the preferred stock and bonds that the money is invested, and it is going to work and they expect to have a return, otherwise they would not have put the money in.

Q. In other words, your answer to my question is [fol. 10308] "Yes" with the amplification you have given?

A. I would say it was, yes. So long as it is a part of invested capital, it certainly has to have a return.

Q. I wanted to get on the record very clearly your theories, and I want you to tell me whether I am right in saying that it is your theory that the moment a dollar goes into the till of a utility, it then should earn a re-

turn, even though it is not yet expended for property in service.

A. I say that so far as the investor, the man who is putting in the money, is concerned, so long as that money stays in the business, he expects a return.

Now, at any time that you want to bring that investor's return to a conclusion, all you have to do is to just declare a dividend or a liquidating dividend or buy his stock or bonds.

Q. Now, your exhibits have been constructed upon that theory, have they not?

A. These exhibits altogether have been based upon the investor's point of view, the man who puts in the money.

Q. And, in effect, you utilize the invested capital as represented by the total of [outstanding] securities and surplus as representing the rate base?

A. Well, I wouldn't want to go quite that far. I have just taken the invested capital, as you have outlined it, and I am not talking about rate base.

[fol. 10309] The Commission, I assume, is going to determine the rate base, but if that rate base still involves the same amount of capital that is in the business now—that is, the moneys that have been put in—then it will take certain required earnings to maintain the credit position of the company.

Q. Well, suppose the Commission fixes a rate base that is, let us say, ten million dollars below your invested capital of $77,830,535 shown in your Chart No. 25. What, then, becomes of your earnings required figure of $5,325,677? Does that figure then go down correspondingly?

A. It will go down, yes, but if the Commission is going—

Q. (Interposing) Should it go down?

Mr. Wheat: Let the witness finish. I think he hadn't finished his answer.

A. (Continuing) It will go down, but I am just saying that the Commission will, I think, very definitely, in determining the rate base that you are talking about, consider what already is in this business.

Now, you can take the extreme case; suppose the Commission comes down with a rate base that is, let us say, twenty-eight million—suppose the Commission comes down with a rate base that is $28,574,090 less than the total invested capital. That just merely means that the Com-[fol. 10310] mission wiped out all the common stock and surplus. Well, there just isn't any. If that can be done and can be worked upon the investors with no difficulty and will stand, why, quite all right, but what you are really saying is that you are just wiping out a part of an investment and there are still some constitutional rights about what a man gets when he buys a security. At least, I think so.

Q. Do you think the constitutional rights of the investor are violated when the Commission uses actual original cost of the property devoted to public service less the depreciation reserves accumulated to date plus reasonable working capital?

A. That depends altogether on what the facts have shown with regard to that determination.

The only point I am trying to make here is that so far as the investors are concerned, if changes are going to be made so that the invested capital is changed to the extent that it actually creates a tangible loss to the investor, then I do not believe that investors are going to continue to finance industrial enterprises in this country.

The financing will have to be done through other than public channels.

Q. Will you turn to Chart No. 46? There it appears that your "minimum earnings necessary to maintain credit position" in the amount of $5,382,000 is a very rigid figure [fol. 10311] and remains constant regardless of the numerous and various assumed rate bases shown there.

Now, how do you reconcile that with your statement a moment ago that the minimum earnings necessary to maintain credit position will go down if the invested capital goes down?

A. Because here, as I have stated, at the present time the bondholder, the preferred holder and the common holder stand in this business $77,830,000, whatever that in-

vested capital was—and that is the amount those various security holders say of their money is still in this business and that is what they expect to get a return on. Now, if we are going to agree that that is the case, then the $5,287,000 is necessary.

What I have just told you is that if some action is going to be taken so that you just wipe out a part of the investment, just take it away from the investor, then the figure I have given you is correct, but I say, if you go far enough along in that, the people that have bought these securities are, at least, going to find out what it is all about.

If you buy a preferred stock or bond, it says very definite things, and they believe there is value behind it, and these various items now are pretty closely checked with the Securities and Exchange Commission, and that is the only way I know that you can continue public financing. Other-[fol. 10312] wise the people will refuse to finance any of these companies.

Q. Mr. Coffman, that takes us back to the illustration which we discussed when you were last on the stand for cross examination, of a corporation having a balance sheet showing $60,000,000 of assets of which $30,000,000 was represented by property actually devoted to public use and $30,000,000 represented cash in the bank. According to your theory, you would allow, in determining the earnings required, a full return upon the $60,000,000 rather than upon the $30,000,000 of cost of property actually dedicated and devoted to public use, would you not?

A. I think I recall about what I said there, and my opinion hasn't changed one iota in regard to it.

The first thing is that I don't think you can find such a situation as that in a going business.

The second thing is that the investor put the money in and if the management wanted to follow a procedure whereby fixed assets are converted finally so that half remains in fixed and the other half in cash in the bank, the investor will tell the management any time or anybody else that he believes that he can use that cash in the bank just as well to make a return by another investment as by leaving it idle there, and, therefore, he is going to tell the manage-

ment. "I want a return on it whether you put it in plant [fol. 10313] or whether you leave it in the bank, because if you are not going to use it, give it back to me, and I will use it."

That is a perfectly sound investor point of view, it seems to me.

Q. And that is why you use as a base, in computing the amount of dollars of earnings required to maintain credit position, the invested capital as represented by the total outstanding securities and surplus?

A. Yes; and to be sure we are talking about the same thing, when you shift from a consideration of total invested capital, as I am defining it, which is the investor's point of view, to discussing the matter from the standpoint of a rate base, as the Commission and utility industry speak of it, we are talking about two different things at that point.

The Commission can determine the rate base as it finds it, considering all the facts, but I am saying, on the other hand, that the investor has put certain capital in here, and unless we can find that there are erroneous entries or other inaccuracies in the accounting, what the investor sees in audited and certified balance sheets, which are given to him, is what he relies upon; it is what he relies upon when he puts more money into it. That is the figure I am going by. Those two things are just different things.

[fol. 10314] Q. On that very subject, are you aware of the fact that there is testimony in this record to the effect that the plant accounts contain a writeup in the amount of approximately one million one hundred thousand dollars, ascribed to gas sales and purchase contracts?

A. Well, I don't know the specific record that you are referring to, but I am aware that there are some gas sales and purchase contracts in some amount. I have forgotten what it is, but on that point, Mr. Littman, I am perfectly willing to make my position clear, that I am using total invested capital here as I have found it from the most reliable figures I can get.

Now, if the Commission makes other findings which show that certain things were inaccurate or improper, then

I would be perfectly willing to use those figures and go forward.

Q. In other words, if there were a writeup of $1,100,000 in plant accounts, then the earnings required to maintain credit position, as that term is used by you, would be correspondingly less than as shown?

A. Would be correspondingly less, and for the reason that there the investors, it seems to me, cannot contend that either good money went in for the value or that earnings had accumulated to create the value.

Q. Now, will you please turn to Chart 3, and I am asking you to do that purely for illustrative purposes. You [fol. 10315] show on that chart certain operating income, do you not, for various years?

A. Yes, I do.

Q. And you have a number of other charts in this Exhibit 253 which show operating income for various years, do you not?

A. Yes, I do.

Q. Now, discussing those charts generally, without making specific reference to them, in arriving at those operating income figures you have accepted the figures as they appear on the company's books without adjustment, have you not?

A. No. In the case of Chart No. 3 and other charts you have referred to, so far as Exhibit 253 is concerned, those now come from Mr. Watkins exhibits, and in particular reference to Chart No. 3 come from Exhibits Nos. 172 and 173.

The percentage calculations I made, but the base figures come from Mr. Watkins' exhibit.

Q. Well, the point that I am driving at is: Neither you nor Mr. Watkins made any adjustments of the company's books in arriving at these net operating income figures?

A. Oh, no. No; that is correct.

Let me answer I don't want to answer for Watkins, but I didn't make any.

[fol. 10316] Q. Well, you don't know of any that he made?

A. No, I don't.

Q. Neither do we.

Now, do you know that there is testimony in this record, that the operating expenses of Panhandle Eastern Pipe Line Company have for the past few years included the amount of $290,000 of charges per year for amortization of a writeup in gas sales and purchase contracts?

* * * * * * * *

A. I don't believe I have the detailed figures here from which I can answer that question.

By Mr. Littman:

Q. Well, I merely asked you whether you know of such testimony.

A. No, I don't know of the testimony; no.

Q. Well, you know of no adjustment that has been made in any of your figures in this exhibit to eliminate such amortization of gas sales and purchase contracts, do you?

A. No, not unless Mr. Watkins made them, and if he did, then I have, because I have used his figures.

Q. Now, assuming that the company is charging $290,000 per year in its operating expenses for the purpose of [fol. 10317] amortizing a writeup, it is clear, is it not, that to that extent the net operating income is understated in those years; isn't that true?

A. Well, let me answer it in this way: If they had decided, if such item as existed as you were describing, to write it off directly, and had made the entry through surplus, then, obviously there would have been no annual amount to be taken care of; therefore, it wouldn't have existed in the profit and loss [acount,] and the earnings would have been higher by that amount.

I merely want to make the point that there is a question in what you say as to the soundness or unsoundness of amortizing a figure on an annual basis. All I will say is that if you should charge an item off all at once to surplus there would obviously be no annual charge.

Q. If an investor knew that the company was amortizing a writeup at the rate of $290,000 a year by direct charges to income through the medium of operating ex-

penses, would he know that the net income per books is understated to that extent?

A. Well, if he can read a statement intelligently, he can make his interpretation, certainly.

Q. If the facts are as I have stated them, then the net operating income figures that you have shown in your exhibits are subject to that adjustment, aren't they?

[fol. 10318] A. If it were decided in regard to that particular point that a change should be made, why, they are subject to that correction; that is right.

Q. Now, you have made no adjustment anywhere in your exhibit for any overaccruals of income taxes, have you?

A. No, sir.

Q. Have you investigated whether the company has recorded on its books larger accruals for Federal income taxes than was actually incurred for those years and paid for those years?

A. No. I have taken the exact figures used in Mr. Watkins' exhibits, and if such item was included there, it is included in my figure. I am not aware of it, but if it is in his figure, it is in my figure.

Q. Now, assuming that there are such overaccruals, according to the company's books for Federal income taxes, then to the extent of such overaccruals, the net operating income is understated?

A. Yes, that would be true, but I would venture a guess that such total, so far as the annual influence is concerned, would not be large.

Q. Well, for your information, Exhibit No. 222, which was presented by Mr. Dunn, shows that there have been overaccruals for charges in lieu of Federal income and excess profits taxes in the amount of $823,882 for State, [fol. 10319] local, and miscellaneous Federal taxes in the amount of $69,550, for Federal income taxes in the amount of $600,530, and for Federal excess profits taxes in the amount of $219,881, over the period April 1, 1932, to December 31, 1941. You wouldn't call those small amounts, would you?

A. What exhibit are you reading from?

Q. 222.

The lines aren't numbered, but you will find it in the column headed "Adjustment for Items Admittedly not Cost."

Well, those things are a matter of record. You, at any rate, did not delve into that problem or make any adjustments for such overaccruals, have you?

A. No, I used Mr. Watkins' figures.

Q. Now, will you please turn to Chart No. 45 which is entitled "Effect of Increased Gross Revenue and Taxes upon Panhandle's Net Operating Revenue."

Now, at the extreme left hand side of this chart, you show net operating revenue in the amount of $6,361,247 pro forma for the 12 months ended February 28, 1942, do you not?

A. Yes, I do.

Q. By "pro forma" you mean that that amount reflects the acquisition of Michigan Gas Transmission Cor- [fol. 10320] poration and the other properties to which reference has been made from time to time in this proceeding?

A. Yes, that is correct, and with the one further qualification that the figure you have just read is on the 1941 tax rates.

Q. That is right. And it is that figure which you compare with other figures there shown under the assumption of Mr. Morgenthau's tax proposals?

A. That is correct.

Q. Now, over on the extreme right-hand side, you show that the "minimum necessary to maintain credit position" is $5,382,677, do you not?

A. Yes, I do.

Q. Well, now, on the basis then of the 1941 tax rates, it is apparent that the Panhandle Eastern and subsidiary companies had excess net operating revenue of one million dollars or, stated differently, had an excess profit of one million dollars over and above the "minimum necessary to maintain credit position"?

A. Yes, I very definitely show that, but I also show, Mr. Littman, that Mr. Morgenthau, so far as I can see, has really already done what the Commission had in mind to do by this proposed tax raise.

Q. Well, he hasn't done it yet, and the Commission [fol. 10321] hasn't done anything yet, either.

A. Well, I say, from his proposal, he contemplates just exactly taking care of that matter.

Q. I assure you I don't know what either are going to do, and I don't think anyone else here does.

A. Well, Mr. Morgenthau wasn't talking through his hat when he made his press release on March 3, I don't believe. At least he hasn't been given to that up to the present time.

Q. Well, now, we are clear, are we, that on the basis of the figures shown here, using the 1941 tax rates, Panhandle Eastern's net operating revenue or dollar return is approximately a million dollars in excess of the amount which you claim is necessary to maintain the credit position?

A. Yes, sir, that is correct.

Q. Now, I want you to do something for me. I want you to tell me how much of a rate reduction would have to be made on the basis of the 1941 income tax rates, in order to reduce the net operating income from the \$6,361,000 to \$5,382,000.

[fol. 10322] A. I have made a calculation, and this I would want to check very carefully.

Q. Let's see how close you come to our figure.

A. According to the result I get about two and a half million dollars.

Q. Well, according to our figures you are about one million dollars too low, but will you please calculate that?

A. I would like to check that more carefully; but that figure once I determine it, is not taking into consideration any change in taxes.

Q. That is right. It is based upon the 1941 tax rate, we understand.

A. All right.

Q. Now you have introduced a number of charts in your new exhibit 253, which did not appear anywhere in your other exhibits previously presented.

Now, those deal with the Bankers' ratios—at least we will call them that for purposes of brevity. Am I correct in understanding that the sum and substance of the findings as you show them, of the New York State Bankers As-

sociation—well, perhaps I have misspoken myself there. Let me repeat:

The sum and substance of these charts is that interest must be earned four times, and the net available for charges must be equal to 16 per cent of the outstanding debt?

[fol. 10323] A. That is for the gas companies integrated, and pipe line also?

Q. Yes.

A. Yes.

Q. And such a status would have the effect of giving the securities of such pipe line company the very highest credit rating?

A. Or, to state it the other way around what the New York State Bankers Association is saying: that in order for a gas bond to be in the A quality rating group it must have at least a times-earned of four, and an income available to par value of sixteen per cent.

Q. Now, assume that we have a natural gas pipe line company with a capitalization of \$30 of debt represented by 3 per cent bonds and \$70 of stock out of each \$100 of capitalization.

* * * * * * * * * * *

A. I missed a couple of points there. \$30 of debt and 3 per cent bonds?

Q. Yes.

A. What next?

Q. \$70 of stock for each \$100 of capital. What is the cost of servicing the \$30 of bonds?

A. That is three per cent on the \$30—\$9.

[fol. 10324] Q. You mean 90 cents?

A. 90 cents.

Q. Per \$100?

A. That is right.

Q. And what is the cost required to service \$70 of stock?

I beg your pardon; I skipped a point.

Assuming that this company was allowed an over-all rate of return of six per cent on its capitalization, what

would be the cost of servicing the $70 of stock on that basis?

A. $5.10.

Q. Now, how many times are charges earned?

A. About $6\frac{1}{2}$ times.

Q. That is right. 6.66, is that right?

A. Yes. Well, I didn't figure it that close. By inspection of figures I said it was about $6\frac{1}{2}$ times.

Q. What is the relation of the over-all net available to par value of debt?

A. You mean the total income to par value of debt?

Q. Yes.

A. It is six per cent. Have I got that wrong? Oh, to par value of debt, pardon me. Twenty per cent.

Q. 20 per cent is the figure we have too.

Now, does this situation meet the Bankers requirements for highest grade bonds?

[fol. 10325] A. Well, you have $6\frac{1}{2}$ times charges, and you have 20 per cent, so that they are both above the ideal.

Q. And yet this company has an over-all return of six per cent?

A. On the basis of the assumption that you gave me.

Q. I would like to have you refer again to chart No. 45. I am afraid I left that chart a little bit too soon. You will recall this is the chart entitled "Effect of Increased Gross Revenue and Taxes upon Panhandle's Net Operating Revenue."

A. Yes, sir.

Q. Now, you not only show the figures to which we alluded a few moments ago of the net operating revenue on the basis of the 1941 tax rates, as compared with the "Minimum necessary to maintain credit position," but you show the effect of Mr. Morgenthau's proposed tax laws upon the net operating revenue, do you not, on the various assumptions?

A. Yes, on various assumed increases in gross revenue.

Q. Now, you show that if the gross revenue remained the same, then based on Mr. Morgenthau's proposal the net operating revenue would drop from $6,361,000 to $4,526,000: is that right?

A. That is correct.

Q. Next you show that if the gross revenue increased $1,154,000 the net operating revenue would go up to [10326] $4,688,000: is that right? A. That is right.

Q. And going to the next bar, you show that in order to raise the net operating revenue to $4,936,000 under Mr. Morgenthau's proposal, it would be necessary for Panhandle Eastern to earn an additional $3,438,000 of gross revenue: is that right? A. That is correct.

Q. And likewise in order for the company to earn net operating revenues of $5,190,000 Panhandle Eastern would have to have $5,771,000 of additional gross revenue?

A. Yes, that is correct.

Q. Each year? A. Each year.

Q. And I observe that even under that assumption—to-wit: the assumption, that Panhande Eastern would earn an additional $5,771,000 of gross revenue—that even then your minimum necessary to maintain credit position would not yet be reached? A. That is correct.

Q. Will you advise us how much additional gross revenue would be required by Panhandle Eastern under the Morgenthau proposal to reach the minimum amount of net operating revenue required, according to your theory, to maintain credit position in the amount of $5,382,677? [fol. 10327] A. Well, I can't calculate that right here. I will have to have some time on that.

Q. Does $7,500,000 of additional gross revenue look about right to you?

You may check it, of course, and report back.

A. Well, offhand, by an inspection, that would sound like a close figure; but I would like to make some calculations.

Q. Let's accept it for purposes of discussion, subject to check. A. All right.

Q. Now, as I understand this chart No. 45, if Mr. Morgenthau's tax proposals go through, then according to your calculation, in order for Panhandle Eastern to even secure the bare-bones minimum necessary net operating revenue for the purposes of maintaining its credit position in the amount of $5,382,000 it will be necessary for Panhandle Eastern to earn 7½ million dollars of gross revenue in addition to that which it earned in the year

1941: is that correct, under the assumptions which we have made? A. That is correct.

Q. And that condition could only prevail and could only be met if Panhandle Eastern didn't spend any money for capital additions: isn't that true?

A. Well, I wouldn't want to say that. If I get your [fol. 10328] point—

Q. (Interposing) I think I could have stated my position more clearly.

Let me repeat it; I think we will be together on it. This chart does not reflect any amounts by you for capital additions, does it? A. No; that is correct.

Q. In other words, under the hypotheses that we have just made, the additional $7\frac{1}{2}$ million dollars of gross revenues would be earned without the expenditure of any moneys for capital additions: is that right?

A. That is correct.

Q. Now, you don't have any thought in mind, do you, that Panhandle Eastern could earn another $7\frac{1}{2}$ million dollars of additional gross revenue without spending any money for capital additions?

Mr. Wheat: Let me ask you, Mr. Littman: Are you assuming there that earnings are on the present rates of the company?

Mr. Littman: That is right.

Mr. Wheat: Present rates as now published?

Mr. Littman: That is right.

I am assuming precisely what the witness has assumed for purposes of chart 45.

[fol. 10329] Mr. Wheat: Without what seems to be indicated as probable necessity for a rate increase, I assume?

Mr. Littman: Yes. We want to get an idea of how much of an increase you people think you have to have, on this assumption.

As I understand it, the company, according to Mr. Biddison, is now earning a hundred per cent on its unregulated business.

We want to see how much more is going to be required each year to meet these requirements.

Mr. Wheat: Your understanding, of course, in that regard, is highly faulty, but go ahead with your procedure.

Mr. Littman: I don't remember whether you answered that last question.

The Witness: I don't remember the question.

Mr. Wheat: He hadn't answered when I asked you the question.

Mr. Littman: Was there an answer, Mr. Reporter?

The Reporter: No, sir.

Mr. Littman: Will you please read the question?

(Whereupon the pending question, as above recorded, was read by the reporter.)

A. I shouldn't think so.

By Mr. Littman:

Q. Well, about how much would have to be expended for [fol. 10330] capital additions to secure another 7½ million dollars of gross revenue?

A. I don't know. Along the general point I would like to say, Mr. Littman: So far as my chart 45 is concerned the only purpose at all in showing it is just one and that is to show that if Mr. Morgenthau's tax proposals do go through the alterations in net operating revenue are going to be rather substantial, and if one would then suppose that you could increase the gross revenue to offset a part I am just saying that if Mr. Morgenthau's proposals go through, or anything like his suggestions go through, it is going to take substantial increases of gross revenue to enable the company to have sufficient money to meet its minimum requirements to maintain credit position, or to have about the same earnings it has now would take substantial increases in gross revenue.

Now, so far as how much plant it is going to take to furnish such additional gross revenue, I haven't made any estimates.

I am not an engineer and I haven't even considered it.

Q. We would like to follow this thing through to its logical conclusion.

It may altogether be that this company is facing bankruptcy or something worse than that, and so we want to follow through.

[fol. 10331] Now, what is the present annual gross revenue of Panhandle Eastern?

A. The gross revenue, gross operating revenue, as contained in the statement for the year ended February 28, 1942, was $18,378,378.

Q. And the total invested capital was how much?

A. Total invested capital was seventy-seven million—

Q. (Interposing) —eight hundred thirty thousand five hundred thirty-five dollars?

A. Yes, that sounds correct. It is correct.

Q. Well, roughly the company has about four dollars of invested capital for each one dollar of gross revenue, has it not? A. Just about.

Q. Just roughly: A. Yes.

Q. In fact that is on the low side, if anything?

A. Well, or turning it the other way around, according to the gross revenue figure it is turning its capital about once in four years.

Q. Now, if the ratio of gross revenue to invested capital were to remain the same, obviously it would take about $30,000,000 of capital expenditures to produce the additional 7½ million dollars of gross revenue, would it not?

* * * * * * * * *

[fol. 10332] A. Whatever figures you use you can get the arithmetical result, but I have made no assumption at all as to increases in plant.

I was merely working on one point: namely, what would have to be done, if the tax increase is an equivalent of a million eight hundred thousand dollars, what has to be done by way of increase in gross to at least partially offset it, and I have made no calculations on the plant account at all.

By Mr. Littman:

Q. Let's see how unreasonable my assumptions are: [fol. 10333] You have increased your annual allowance for

amortization in direct proportion each year, have you not, to the increase in gross revenue; don't your calculations show that?

A. Which exhibit are you talking about now?

Q. I am talking about your chart No. 45, table supporting chart No. 45.

A. I don't follow your remark about amortization and so on. What is your point?

Q. Haven't you assumed, for purposes of chart No. 45, that your expenses are going to go up directly proportionately to your gross revenue?

A. What I assumed was that the ratio of operating expense to gross revenue, as existed February 28, 1942, that percentage would remain the same.

Q. And that includes depreciation and amortization, doesn't it? A. That is correct.

Q. In other words you were providing for amortization of sufficient invested capital to provide for this increase or these various increases in gross revenues under the various assumptions, were you not?

A. Well, that is generally correct. It would increase by the percent I have stated.

Q. And your increases for depreciation and amortization are in direct proportion to the gross revenue increase [fol. 10334] assumed by you, are they not?

A. Well, they are in proportion to the amount of the percent that is used, sure.

Q. Well, certainly that assumption presupposes that your plant and property account was going to increase in the same proportion, does it not?

A. Well, it isn't quite as good a case as you are making out, Mr. Littman, because amortization and depreciation is just one of the many items of operating expenses. In other words, the operating expenses, excluding the taxes, were about 6½ million, so it isn't quite—when you say "direct proportion" I don't like to see you load it all on the amortization and depreciation: that is going a little too far, I would say.

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Q. Very well. That gets us up to something like $30,000,000 on that assumption of capital additions that would be required under my assumption.

Mr. Wheat: And under present rates for the service?

Mr. Littman: Yes.

[fol. 10335] By Mr. Littman:

Q. (Continuing) Under all the assumptions, and there are a great many of them under chart No. 45.

You would have about $30,000,000 of capital additions wouldn't you?

A. That would be about right.

Q. In order to produce the additional 7½ million dollars of gross revenue? A. That is right.

Q. Now, the minute you get into a situation like that and you have another $30,000,000 of capital additions, why, your "minimum necessary to maintain credit position"—or, differently stated, your return—has got to go up too, doesn't it?

A. Well, the capital additions can't come out of the air. They will have to have money to finance it, or earnings to finance it, one or the other.

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[fol. 10337] Mr. Wheat: We have succeeded in borrowing, through the courtesy of Commission's counsel, a copy of the exhibit of Mr. Coffman in the case involving valuation of common stock of Carolina Power and Light Company, to which Mr. Littman adverted this morning, and since this exhibit, I think, is from the files of the Trial Examiner in that case, we should like to be able to return it.

It will only take us one moment to ask the one question we would like to ask on that, if we may be allowed to do that.

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By Mr. Wheat:

Q. Mr. Coffman, you heard Mr. Littman read to you this morning a passage which included, I think, two sentences from your text which appears in the exhibit in question opposite chart No. 6, and I think that is exhibit 307 in [fol. 10338] Docket—

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Q. (Continuing) Well, in the case which has been pending, involving Carolina Power & Light Company.

Did you hear Mr. Liftman read those two sentences, Mr. Coffman?

A. Yes, I did.

Q. I should like to ask you whether those two sentences are a portion of the following text:—

Mr. Wheat: I don't think, Mr. Examiner, possibly, that I need to read this all into the record, if it may be quoted in the record.

It starts with the beginning of the chart—it will only take me a minute. I will read it.

By Mr. Wheat:

Q. (Continuing) "On Chart No. 6, captioned 'Carolina Power & Light Company Common Stock, Daily Price Range & Trading Volume—January 1, 1925 to April 6, 1926' I have reviewed the market action of the company's common stock during the year prior to the date of valuation.

"As noted on the chart, there was no trading in the stock on the New York Curb Market after December, 1925, [fol. 10339] at which time all of the common stock outstanding of the Carolina Power & Light Company had been acquired by the National Power & Light Company through an exchange offer of 15 new shares of National Power & Light Company common stock for each share of Carolina Power & Light Company common stock. Accordingly, my review covered the calendar year 1925.

It will be seen from the chart that at the beginning of 1925 the Carolina Power & Light Company common stock sold at a price of $319 per share.

"After the sale of few additional shares at 320 and 329½ during the month of January, the stock declined to a low of 300 on the sale of only 10 shares on February 16. In March, however, the shares jumped to a high price of 360 on an increasing number of shares trades.

"The market was quiet during the month of April around the 340 level, but in May, the price soared to a high of 430, or an increase in value of some 26 percent.

"During the last six months of the year the stock fluctuated between a low of 375 reached both in June and September and a peak of 456½ attained on November 5. Volume of shares traded also reached the highest level on November 5, amounting to 1,220 shares.

"It is obvious from this review of the market action of the common stock of Carolina Power & Light Company the year preceding the date of valuation that the market was an [fol. 10340] extremely thin affair, with wide fluctuation occurring on only a small number of shares traded. In view of the thinness of the market, and the fact that no quotations were available subsequent to December, 1925, I considered it necessary to approach the determination of a fair market value of the common stock of the Carolina Power & Light Company as of April 6, 1926, on the basis of earning power." Does that represent the testimony which you gave in that case?

A. Yes, it does.

Q. And the part which I have read, which was also previously read by Mr. Littman, is that portion only following the words beginning "It is obvious that this review"; is that correct? A. That is correct.

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[fol. 10344]

Paul B. Coffman having been heretofore duly sworn, resumed the stand and was examined and testified as follows:

Recross Examination (Resumed)

By Mr. Littman:

Q. Mr. Coffman, during the last session I asked you to check one or two figures in connection with Chart No. 45 of Exhibit No. 253 which chart was entitled "Effect of increased gross revenue and taxes upon Panhandle's net operating revenue."

The first one that I recalled dealt with the amount of gross reduction in rates that would be required to bring about the indicated reduction net to the company in order to reduce the net operating revenue from the $6,361,247 shown for the full year 1941 shown in the—

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[fol. 10345] By Mr. Littman:

Q. (Continuing)—which was computed on the basis of the 1941 tax rates to the figure of $5,382,677, which is the "minimum necessary to maintain credit position."

A. The figure which I calculated would show approximately $3,390,000. In that connection, however, I would like to say that in using some figures that Mr. Watkins had made showing a reduction of approximately a million dollars which is about the difference we are talking about —that is, from the $6,300,000 down to the $5,300,000 which we are talking about, on his basis would indicate something slightly under $3,000,000, but the figure I have is $3,390,000 for checking your calculation.

Q. Now, Mr. Coffman, in order that there may be no confusion in the record, I want you to very briefly explain what this $3,300,000 figure represents. I want it stated in our own language so that there will be no misunderstanding.

A. Referring to Chart No. 45 in Exhibit 253, I show in the first column captioned "Pro forma 12 months ended February 28, 1942, based on 1941 tax rates," net operating revenue of Panhandle on the consolidated basis of $6,361,247.

On that same chart No. 45 in Exhibit 253, I show a last column captioned "minimum necessary to maintain credit position" of $5,382,677, which is the base figure as originally determined on Chart No. 26 in Exhibit 253.

[fol. 10346] The question was how much of a reduction in gross revenue would be made to bring the $6,361,247 down to $5,382,677 and the calculation, as I have made it, would indicate that gross revenue could be reduced $3,391,000 on that basis, although, as I have explained, calculations based upon Mr. Watkins' figures would indicate that a more correct figure was something slightly under $3,000,000, but I believe the difference there comes in the fact that I used a consolidated figure, whereas on his computations, I think he worked it out for Panhandle, for Michigan Gas Transmission, and so forth, because those various companies, as you know, have different tax bases, which would make a slight difference, but I used the overall figure and made the calculations.

Q. Will you please refer to Mr. Watkin's exhibits that led you to the slightly less than $3,000,000 figure, to which you just referred?

A. Well, his figure is not contained in a separate exhibit, as such, but working from figures that he had placed in his exhibit, so far as taxes and so on are concerned, he indicates that, based on 1941 tax rates, a reduction in gross income of $3,600,000 would show, taking into consideration excess profits tax of $1,514,000 and normal taxes of $461,000, that the reduction in net operating revenue based upon the 1941 Revenue Act would be a million twenty-five thousand dollars, and the difference between the [fol. 10347] $6,361,247 and the $5,382,677 equals $980,570, which is somewhat lower than his $1,025,000, so I have concluded from that that on his basis of calculation, the amount of reduction in gross revenue would be slightly under the $3,000,000, which was his original base of calculation.

Q. To summarize, if we use the 1941 tax rates in our calculation, the indicated rate reduction necessary to bring your net operating revenue down to your "minimum necessary to maintain credit position" is something between about three million, according to Mr. Watkins, and $3,300,000-odd, according to you?

A. Well, say something less than $3,000,000, according to Mr. Watkins and $3,300,000-odd, according to me; that is correct.

Q. In connection with this same chart No. 45, Mr. Coffman, on last Saturday I gave you a figure of seven and a half million dollars of gross revenue increase over the gross revenue of Panhandle Eastern and subsidiary companies for the 12 months ended February 28, 1942, which we computed was, according to your assumptions in Chart No. 45, required to bring about the net operating revenue of $5,382,677, which you call "minimum necessary to maintain credit position" in Chart No. 45.

You stated that the figure sounded about right to you; that is, the seven and one-half million dollar amount of [fol. 10348] gross revenue increase, and I believe you

said that you were going to check that figure. Have you done so?

A. Yes, I have checked that, and seven and a half million dollars is the figure. That is, there are a few odd dollars, but in round figures seven and a half million is correct.

Q. Substantially correct? A. Yes, that is right.

Q. I would like to have you turn now to Chart No. 11 in Exhibit 253, which chart is entitled "Investors' Appraisal of Over-all Capital Risks, 153 Stable Industrial Companies." Is my understanding correct that in this chart you have summarized the data which is compiled in the rather voluminous exhibit for identification No. 254, Sections I, II, and III; this exhibit being entitled "Investors' Appraisal of Risks of Capital in 153 Stable Industrial Companies for the years 1937-1941, inclusive"?

A. Yes, that is correct. Of course, you are aware that in this same volume to which you refer is a section IV which gives the detailed information on Chart No. 10.

Q. Yes.

A. Just so that we account for the whole Exhibit 254.

Q. Yes. Well, I wanted, for the present, to discuss your Chart No. 11 of Exhibit 253. A. Yes.

[fol. 10349] Q. Now, the upshot of your study in this connection is that the weighted average "Investors' Appraisal of risks of Capital" for these 153 stable industrial companies for the five years 1937-1941, inclusive, is 6.97 percent. A. That is correct.

Q. And for the year 1941, the investors' appraisal is 7.99; is that right? A. Yes, sir.

Q. For 1940, it is 7.14; for 1939, 6.25; for 1938, 5.2?; and for 1937, 6.83? A. That is right.

Q. Have I read the figures correctly?

A. Yes, sir, you have.

Q. Mr. Coffman, I would like to read a portion of your testimony given on April 17, 1942, on direct examination at page 10152 of the transcript of testimony. I would like to read this so that we may discuss this part of your testimony:

"Question: Now, you have told us what your eliminations were and given us the number of companies elim-

inated. Will you go ahead and discuss, briefly, the reasons behind these eliminations?"

You were, of course, here discussing your Exhibit No. 254, were you?

A. Yes.

Q. And Chart No. 11 of Exhibit 253? A. Yes.

[fol. 10350] Q. Is that right? A. That is correct.

Q. "Answer: I was principally interested in the common stock phase because the common stocks in any company are the ones which depend for their return on the type of risk involved. In other words, their bonds carry very definite stipulations as to interest, sinking funds, and so forth, so that if any company should, some place along the line, run into difficulty, presumably the bondholders are the best protected of the various security holders of securities in a particular corporation."

I shan't read the balance of the answer unless you feel it is necessary as we discuss the problem.

Now, am I correct in understanding from that statement that in your judgment the investors' appraisal of risks of the common stock of these 153 stable industrial companies is important in connection with this proceeding?

A. No. If I understand your question correctly, the information shown in Chart No. 11 is the investors' appraisal of over-all capital risks, that is, taking into consideration the bonds, preferred stock, and common stock, but when it came to the process of elimination to arrive at the 153 companies, it seemed to me that if a company had paid a dividend on its common stock each year for a ten [fol. 10351] year period that was about as close a measurement of stability for an industrial corporation as I could find, so that I used the regularity and continuity of dividend payments, although the dividend payment might have varied from one year to another, of common stocks as the final test of arriving at whatever the resultant figure was, which was 153 industrial companies, but so far as the figures contained in Chart No. 11 of Exhibit 253 are concerned and the supporting data in Exhibit 254, it covers the over-all capital risks.

My point is that to determine whether an industrial company has any degree of stability, in my opinion, the best test is whether an industrial corporation has been able for a period of years—and here I said ten—to pay a dividend on its common stock each year.

Q. Well, is it true to say that the common stocks of natural gas pipe line companies, such as Panhandle Eastern, compete in the money market with the common stocks of companies such as these 153 stable industrial companies?

A. Yes, I should think all the securities of various companies are competing in the market for investment money.

Q. In other words, one type of security of one company competes in the money market with the same type of security of another company, generally speaking; isn't that true?

A. Well, I think that is refining it somewhat. What [fol. 10352] you mean by your question, I take it, is that a common stock of any company, let us say, in the utility field, would be competing against any common stock in the industrial field.

Well, I believe that is true, but I wouldn't want to confine myself quite so much, because an investor might well consider a common stock in one company or one industry, whereas if he went to another company in the same industry or a different industry, he might not consider a common stock, but would be more interested in a preferred, so there I suppose you would say that preferreds were competing with common, and the reason for that is that the investor is trying to the best of his ability to size up the possibilities of this one investment against another.

Q. Well, isn't it true that an investor who is interested in investing his money in common stocks surveys the common stock market and compares the risks and returns of industrials with those of utilities before making up his mind? Isn't that generally correct?

A. Yes. To make my answer complete: if we had a client who had a certain amount of funds for investment who said that he was interested only in common stock, then, obviously, he would, himself, look over all available common stocks or have us, his investment advisors, do it for him, and then recommend those common stocks we thought best.

Q. And is it true to say that your study of the 153 stable [fol. 10353] industrial companies represents your judgment of those companies whose common stocks are most comparable in stability with the common stock of natural gas pipe line companies?

A. Well, I don't believe one could quite say that from the information that is in Chart No. 11. At least, that wasn't what I had in mind.

What I set out to do was to study the over-all risks of capital in the industrial field. Well, obviously, there are thousands of industrial companies, so I couldn't possibly, in any short space of time, cover them all, nor did I think it was necessary.

In order to arrive at a list which would at least bring it into a number that I could handle within any reasonable length of time, I followed the procedure of elimination described and which is in the record and which finally gave me 153, and because I used as my principal guiding light at the end those companies which had paid a dividend on their common stock in each year, made these 153 companies, but my findings or conclusions, so to speak, cover the over-all investors' appraisal as against a common stock treatment.

The only reason we used the common stock was to try to get at this stability of one company against another.

Q. What you wanted to obtain was a list of the most stable industrial companies?

A. That is what I was trying to get at.

[fol. 10354] Q. And that was, I take it, because you felt that it was the most stable of the industrial companies that were most comparable with the securities of natural gas pipe line companies?

A. Generally, I think that is correct.

The Witness: May I just have that question and answer read so that I can be sure the common stocks are not mixed up?

(The record was read by the reporter.)

A. Well, I don't understand quite the "comparability." The word "comparability" in other words, bothers me there.

All I was trying to do was get the over-all risk of capital in the industrial field which was unregulated, and felt that if I took the companies that had these dividend payments over a period of time which indicated the stability, that I would get an idea of what ~~investors~~ for over-all capital required, and that figure weighted average for a five-year period was 6.97 percent.

Now, relating that to the utility field, it seemed to me that in a regulated industry where you also were to have, as I understand it, a degree of stability because of regulation and being allowed a fair return, that in a state of competition where you live or die depending upon managerial ability and other factors, the weighted average for a five-year period is approximately 7 percent. Then I concluded that in a regulated industry, certainly that 7 percent would more or less prescribe a minimum, and I did not go [fol. 10355] to any greater extent by way of talking in terms of comparability, because I don't see that there is comparability shifting from the industrial field to the utility field.

Q. Well, are you saying that these industrial companies are as stable as the utility industry?

A. I don't think I would put it quite that way, Mr. Littman, but what I am saying: If you go from a regulated industry to something outside that field because, as I understand it, there were statements in the Bluefield case which I think were read, and I couldn't quote but could read it again, of other industries outside the regulated field. I went into the industrial field and selected out of that field those that had the greatest stability, but naturally were unregulated and were facing competition, and it seemed to me that if, in the face of that competition, the investors over-all were appraising that risk at around 7 percent, and those companies had a degree of stability, although they were ~~unregulated, so~~ that such stability would begin to approach the stability in a regulated field, that there was there some guide to be used as one additional factor in a consideration of this over-all matter.

Q. Some of these "stable industrial companies" actually had deficits in some of the ten years, even though they paid dividends in those years; isn't that a fact?

[fol. 10356] A. Yes, that is a fact, but my point is that

that is no different, really, as I see it, than the public utility field. For example, I can't give the specific dates, but some place along in the depression years—1932 or 1933—American Telephone Company, for example, paid out in dividends more than it earned, but if from one year to another you can accumulate, even though you have a deficit one year, you can accumulate earnings so that over the ten-year period the dividends you earned were out of earnings and not out of capital, why, that is about as good as you can expect. I don't think you could say that a company should earn some money each year. That is asking too much with the business cycle coming on from time to time.

Mr. Wheat: When you say "some money each year," you mean some money available for dividends?

The Witness: Yes; some money available for dividends.

By Mr. Littman:

Q. You don't go any farther than 1937 in your study?

A. No, in my study I covered just the last five years, because it seemed to me that was the most recent information, and, therefore, the most pertinent.

Q. Then, are you or aren't you saying that these 153 industrial companies are more stable than the utility industry?

A. Well, I wouldn't want to word the answer that way, [fol. 10357] Mr. Littman, because that wasn't what I had in mind.

I feel that when I go from the utility industry to any other industry there are differences immediately so that you have to recognize those differences and you can't, therefore, say that they are comparable, but my whole point of view is that the 153 industrial corporations were, so far as I can see, as stable as any industrial companies you could find.

On the other hand, I had understood that regulation of the public utility industry, among other purposes, was to add some stability to that, so that there is some stability in each group, but to say that 153 are equally as stable as the utility industry, I wouldn't want to say that. It was the next closest thing I could find outside of the utility

field for whatever additional advantage it would have to these figures.

Q. The latter part of your statement is somewhat close to our understanding, namely, that the utility industry is over-all more stable than industrial companies, even the most stable industrial companies; isn't that true?

A. There again you are pinning me down to whether they are equally stable, which is difficult. I am looking at this, bear in mind, right along from the investor's point of view, and, as I see the investor, he is here on the outside with a thousand dollars or many thousand dollars looking for a place to place his money.

[fol. 10358] Now, if he finds over a period of time that the over-all risk of capital should be less in the utility field than he could find in 153 industrial companies with considerable stability, I should suppose he would begin to shift his investments from the utility field, generally to to these 153 industrial companies, let us say, because he finds there that putting a thousand dollars in gives him about the same stability that you have in the utility industry, but a higher return, and, therefore, from that, I had concluded that the 6.97 percent would more or less prescribe a minimum from the investor's point of view, because if he can fare better from another investment than he can from something in the utility field, he will make the investment on that basis.

Q. Mr. Coffman, isn't it a fact that the capital structure of utilities is considerably different from those of industrials in that utilities have a very much larger percentage of debt capital and preferred stock?

A. Yes, I think that is generally true.

Q. It is certainly true that Panhandle Eastern Pipe Line Company has a capital structure considerably different from the average of the industrials which you show, in that it has a much larger percentage of debt capital and preferred stock than these 153 industrials; isn't that correct?

[fol. 10359] A. Well, I haven't actually taken an average of these industrial companies, but it would seem to me that your statement was true, except that to make just a hidebound answer, I would feel better to have made the cal-

culations, but it sounds very reasonable to me, knowing what I do about the industrial companies.

Q. Well, are we agreed, Mr. Coffman, that the actual cost of the securities of the Panhandle Eastern Pipe Line Company are to be used in determining the fair return under your approach?

A. Well, as I have shown in Chart No. 26 of Exhibit 253, I used the 2.88 percent for the bonds.

Q. Pardon me. That is actual, isn't it?

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A. But that actual closely approximates the average for high grade corporation bonds, so that it is more or less in tune with the present day capital market conditions. However, when you come to the preferred stock, I feel that the 6.23 percent, which is not the actual, should be used for reasons that I had developed in connection with charts Nos. 17, 18, 19, and 20, in Exhibit No. 253.

Q. Well, the actual cost of the preferred stock is shown in Chart No. 25 of Exhibit 253, to be 5.87 percent; isn't that right? A. Yes.

[fol. 10360] Q. And you have adjusted that upward, as you have, I think, heretofore explained, and I think amply enlarged upon, you have increased that to 6.23 percent, as shown in Chart No. 26? A. Yes, that is correct.

Q. Now, with that one exception of that latter adjustment, you have used for the purpose of your study actual cost of the bonds and preferred stock for the purposes of this study and your approach, haven't you?

A. Yes; and the reason that I have done that is because it so happens that in this instance that both a new issue of bonds and a new issue of preferred stock have been made, so that you had what you might call the most pragmatic test.

In other companies where there have been no issue of bonds or preferred stock, then obviously I study what the market seems to indicate.

Q. Now, that leaves, does it not, for determination by way of judgment only the proper return applicable to the common stock and surplus?

A. Generally, that statement is correct.

Q. And you judge the proper return to be 12 percent for the common stock and surplus, as shown, I believe, in your Chart No. 26 and Chart No. 25 as well? A. Yes. [fol. 10361] Q. Now, what we then are very anxious to have in the record, what we are actually seeking is common stock comparability, aren't we?

A. Well, I had thought that the subject had been explored fairly fully so far as the common stocks in the utility industry go, which are the ones we must rely on to give us some indication about what the investor is saying about common stocks in the natural gas division of the public utility industry, and I thought in Exhibit No. 65 and in Exhibit No. 253 that had been developed.

Q. Well, Mr. Coffman, might it not be very helpful to the Commission, in assisting the Commission to estimate the proper return applicable to Panhandle Eastern's common stock, to determine the investors' appraisal of risks of common stocks of these 153 stable industrial companies? Don't you think that information would be helpful and important?

A. Well, such study could be made to see what the result is. I haven't any idea, as a matter of fact, what it might show, and I would be perfectly willing to get the figures together, but it would seem to me, even after the figure, that when we considered the Panhandle Eastern Pipe Line Company, we would still want to confine our attention fairly closely to the experience of other pipe line [fol. 10362] companies and, in that regard, we already have the evidence in the record as to what the common stocks are doing.

Q. However, there is a rather limited number of natural gas pipe line companies for comparison that you have studied?

A. That is true, but, as I think I have stated in times past on the record, so far as I know, I have included all of the natural gas pipe line companies in the industry upon which investors' appraisals can be made, which would give you all of the coverage, even though the industry is small, that you could possibly produce.

Mr. Wheat: Just to make sure of what he is referring to, I wonder if I could ask this question: when you refer to these natural gas pipe line companies, you include all

of those that you used in making up the natural gas pipe line company portion of your Chart No. 10?

The Witness: Yes, that is correct. In other words, I say that all of the companies upon which an investors' appraisal of over-all risk of capital for all natural gas companies and natural gas pipe line companies, as contained in Chart No. 10 of Exhibit No. 253 and tables supporting such chart, to my knowledge, are all the companies in this industry upon which you can get an investor's appraisal or upon which there are figures available to make such calculations.

[fol. 10363] By Mr. Littman:

Q. When you speak of all the gas pipe line companies, you are speaking of all six of them, including Panhandle Eastern, aren't you?

A. That is true, there are six, but I am saying that those are all upon which figures are available for such calculations as I have described as investors' appraisal of over-all risk of capital.

Q. There is no way for you to include, for example, Natural Gas Pipe Line Company of America common stocks that you have testified as one of the most comparable pipe line companies to Panhandle Eastern?

A. That is true. If the various securities on the great bulk of securities contained in a company's capital structure are not held or a part of it held by the public so you can get a market quotation, then obviously it is not included in the study.

Q. Then naturally that had the effect of reducing the available number of companies for the purposes of your study down to five other than Panhandle Eastern?

A. Yes, that is correct.

Q. You couldn't include Colorado Interstate Company for that reason, could you?

A. For the same reason; that is correct.

Q. Now, you have stated that you have not made a [fol. 10364] study of the common stocks of these 153 stable industrial companies; is that correct?

A. Yes, that is correct.

Q. That, I take it, was simply because you didn't have sufficient time to make such a study?

A. That is correct. I was just able to get done, as you know, what I have here and very few copies of that.

Q. I understand you were very much pressed for time.

A. Yes, sir.

Q. But if you had had sufficient time, would you have made a study of the investors' appraisal of risks of the common stocks of these 153 stable industrial companies?

A. Yes, I would have, and beyond that, I think, if I had the time I would look at new issues over a period also to see how they were moving, such as I did in the case of Northern Natural on its September 10 offering.

Q. And such a study, to wit, study of the investors' appraisal of risks of common stocks of these 153 stable companies, would, in your opinion, be a pretty good guide to be used in determining the proper investors' appraisal of risk for natural gas pipe line company common stock?

A. Well, I wouldn't make a statement just like that, because, as I say, in the last analysis it seems that for the purpose of the main study; you still have to talk in terms of regulated industry, and, more particularly, in the divi- [fol. 10365] sion, the specific division that we are talking about, and what may be shown in 153 industrials is just additional information that may give a broader view, but I wouldn't want to get it any closer than that, by saying it would be the guide or a specific guide.

Q. But it would be a very helpful guide?

A. Well, I think it would certainly be an interesting figure. How much weight can be given to it, how much use can be made of it, I don't know. I would want to think that over and give some study to it.

Q. Well, it would be just as important, if not more so, would it not, than the investors' appraisal of risk of capital for these 153 stable industrial companies which you have shown in Chart No. 11 on an over-all basis, wouldn't it?

A. Well, it would carry the same weight, I would say, as this, but my point is that I haven't used the material in Chart No. 11 directly any place. It was just an additional item to have a look at, but when it got down to working out my actual results, as you know, I have confined my attention right along to the utility field, and,

more particularly, the natural gas division of the utility field.

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Redirect Examination

[fol. 10366] By Mr. Wheat:

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Q. Now, with respect to these questions that Mr. Littman has put to you which dealt with what he termed comparative stability, is it a fact or is it not that the investors' appraisal of natural gas pipe line company securities over all indicates that investors do not, as a matter of fact, appraise such securities of such companies, in general, as [fol. 10367] highly as they do those of the 153 stable industrial companies which you have studied?

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[fol. 10368] The Witness: Well, I still say that that question is confusing, because—appraised "as highly"—they actually appraise the gas companies more highly than they do the 153 industrials.

In other words the figures over all for gas companies are higher than the industrial companies.

By Mr. Wheat:

Q. That is the point I was asking you about. Would you say that if an investor demands a higher return from one company than he does another, that he appraises the one from which he demands a higher return as highly as he does the other?

That is the only point of my question.

A. Well, if you will let me answer it in my own language, perhaps I can get at it better.

Q. Yes.

A. The investor is saying, from these facts shown in charts Nos. 10 and 11, that so far as his investment and his requirements for securities in the natural gas companies and the natural gas pipe line companies, he demands more as an over-all return on capital than would be indicated that he was demanding on the 153 industrial companies.

Therefore, so far as my interpretation is concerned, the investor is saying that he believes there is more risk attaching to natural gas companies and natural gas pipe line companies than was the case in the 153 industrial [fol. 10369] companies.

Q. Mr. Coffman, looking at chart No. 10 covering those various divisions of utility industry which is there shown, does the same variance in investor appraisal clearly appear?

A. I think that the information shown in chart No. 10 of Exhibit 253 shows clearly that the investors confining their attention to the public utility industry have shown that water companies in their opinion were carrying a lesser risk than companies in the electric operating utility field, and those were less than the manufactured and mixed gas companies, and the latter in turn were less than all natural gas companies, and the all-natural gas companies were less than the natural gas pipe line companies.

It seems to me that for a five-year period those figures indicate that conclusion pretty clearly.

Q. Mr. Coffman, Mr. Littman questioned you yesterday about some possible adjustments in the investment figure shown on your chart No. 25 and 26, which were suggested in this record by Mr. Dunn of the Commission's staff. Let me just ask you this:

I think you stated, did you not, that any change in the $77,730,535 figure which might be made would affect your earnings required to maintain credit position by the same percentage that the latter figure bears to the invested [fol. 10370] capital figure?

A. Well, I recall that question, and I remember that my answer was rather long and perhaps somewhat involved.

But what I would like to get clear, so far as my own understanding of this matter is concerned, we are talking about two things:

In the first place, throughout Exhibit 65 and Exhibit 253 I have been taking the investor's point of view and have been using total invested capital per the books of the given company.

Now I say that unless it can be demonstrated that the book figures are in error, that the investors in the given company have placed in the company, or, by use of the assets they put in earnings, have accumulated or accumulated to a total of $77,830,535, and that is the amount that the investors believe they have invested in the business and is, therefore, the amount upon which they require a return.

Now, if we go over to a different consideration, namely, a rate base, and it is there found that some other figure than total invested capital may be determined, unless it can be shown that the total invested capital is actually not there so far as the securities outstanding are concerned, the investors will still require the $5,382,677 as shown in chart No. 26 which is a return upon the total invested capital of $77,830,535, irrespective of what the rate base may [fol. 10371] be, and I thought I had made my position clear by my last chart No. 46, in which, if the total invested capital represents what the investors have in this business, and the $5,382,677 is required to keep them in position to refinance or further finance this company, when it is needed, then you can select or determine any rate base you place; but you must allow a percent on such rate base as will give you $5,382,677.

Now, as I say, I don't recall just how I answered the question before, but I believe, in this answer, I have made my point of view clear, that I had hoped I had made clear before.

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[fol. 10372] Q. Mr. Coffman, if you will turn to your Chart No. 8 in Exhibit No. 253. Do you have that before you? A. Yes, I do.

Q. I think during the cross examination, Mr. Littman asked you to make a mathematical calculation of subtracting the $6,576,743 shown as net working capital on Chart No. 8 from the invested capital of this company. I think you made the mathematical calculation, didn't you?

A. Yes, I did.

Q. Do you consider that the reduction of invested capital by this net working capital figure involves a realistic

assumption of any sort in connection with the operations of this company and the investors' appraisal of its risks?

A. No, I do not because here again, in connection with the point I have already made, taking the investors' point of view, the total invested capital amounted to $77,830,535 as shown in Charts Nos. 25 and 26 in Exhibit No. 253 and that is as of February 28, 1942, the total invested capital, so that, as I think I have explained before, so far as my study is concerned, you cannot eliminate that because it actually exists.

[fol. 10373] Now, any assumption other than that, it seems to me, again is talking about this matter of the rate base, whatever the Commission may determine that to be as against the thing I am talking about, namely, the total invested capital. $6,576,743 actually exists. It is there. It is a live, tangible asset.

Q. Yes. Is there anything further you wish to say on that point?

A. Well, on that point, as far as the calculations were concerned that I made before, it then comes down to a question of managerial policy. If there is to be any reduction in working capital, in other words, the working capital can be used for a number of purposes and you cannot eliminate it, so far as my study is concerned from consideration unless you determine how it is to be used.

Q. You have shown one way in which it will be eliminated during the current year, haven't you?

A. Well, on the basis of the estimated plant expenditures, I have shown that provision has already been made for its use in the amount of $6,530,900.

Q. Well, if it were not used for that purpose, what other purposes fit within what you have mentioned just a moment ago as sound managerial policy?

A. Well, if it were determined by the management that the $6,576,743 of working capital were not needed for plant [fol. 10374] expenditures which development is now under way, then obviously, the management could use the working capital to reduce the debt which it would seem to me would be the procedure to follow in view of the fact that, of the total capital structure, the debt portion is the only portion in which trouble could develop in case there

was any default in meeting the serial note payments or in meeting maturities or interest payments on the bonds.

Therefore, if a portion or all of the working capital were going to be used, it would seem to me that any reduction thereof should be made on the basis that you were paying off your debt.

Q. What effect would that have on your minimum necessary earnings?

A. Well, I do not have the figure, but I can calculate it the same as I have made the other calculations.

Turning to table supporting Chart No. 26, it is shown therein that there are Serial Notes A, B, C and D coming in various maturities from November 1, 1942, to 1945, in the amount of $5,000,000 and first mortgage and trust lien A, in the amount of $6,250,000, maturing from 1946 to 1950 and, if I were to work out a schedule on those, taking the interest on the various items, I would find that, on the first series, there is 0.75 per cent—

Q. (Interposing) That is the serial notes?

[fol. 10375] A. Serial notes of the A, B, C and D group, carrying 0.75 per cent of interest; the next group one per cent; the next group 1.25 per cent; the next 1.50 per cent; and the next 1.65 per cent which would give you an average rate for the five pieces of debt of 1.25 per cent and, if you applied that to a figure of $6,250,000 which consumes most of the net working capital as existent on February 28, 1942—

Q. (Interposing) You could retire some of the 3's or some of the preferred stock if you wished, couldn't you?

A. Yes, you could do that but first applying it to the debt, and I will tell you why I think that is a more realistic approach.

The total reduction from the standpoint of requirements would then be $78,125 which should come off or be subtracted from the $5,382,677 of earnings requirements on the new total invested capital which would be $77,830,535 less $6,250,000 of working capital so used, giving a resultant total invested capital then left in the business of

$71,580,535 and, on that basis under that procedure, the earnings requirements then would be $5,304,552 in contrast to the figure I show in Chart No. 26 of $5,382,677.

Now, so far as the other bonds or the preferred stock is concerned, looking at it from the managerial point of view, it seems to me that to assume that working capital is not needed in the business, the only approach then you can take [fol. 10376] to its reduction is applying it against the most important maturities which are the near term maturities which are the very issues that I have just used because the longer term debt does not mature until 1960 and 1962 so that there is no immediate pressure in regard to those issues and, so far as the preferred stock is concerned, even though it carries a sinking fund, it nevertheless is still a preferred stock so far as dividend requirements are concerned. In other words, there is no possibility of default there such as you would have if you failed to meet any of the maturities in your serial notes so that, so far as I can see, the proper approach, if any is to be made in regard to the reduction of working capital should, in soundness of managerial policy, follow the course of procedure I have outlined which, if it were followed, would give the results I have just stated in the record.

Q. I wish you would turn now to your Chart No. 45 for a moment. I think you have already stated, Mr. Coffman, that the three bars showing various assumptions of increasing gross and net operating revenue were taken at the points you took them merely because you took certain actual figures as shown on that chart from the history of this company? A. Yes, I did that.

Q. And I think you have already also stated that the illustration could just as well have been made by assuming [fol. 10377] various increases in gross of an even million, two million, three million, et cetera, dollars, is that correct?

A. That is correct.

Q. Now, Mr. Littman asked you some questions on Saturday as to whether or not the capital invested in this company would have to be increased in proportion to such increases in gross revenue in order to handle the business. Did you entirely complete your explanation of that situation when you answered him Saturday?

A. Well, I do not recall just the answer but the point I was trying to develop was, in the first place, in my study I did not make any consideration of increased plant that would be necessary for any increased gross revenue and for the reason that it seems to me that the consuming market at the point of consumption, in the last analysis, will determine such additions to plants as are necessary to take care of any expansion of service and that to me is a separate study. I gave no attention to that.

The only purpose I had in mind in showing the facts as shown on Chart No. 45 of Exhibit No. 253 was that if anything like the proposals made by Secretary of the Treasury, Mr. Morgenthau, should finally become the new tax law then there will be such reduction automatically by virtue of the increased tax rates in the net operating revenue as to reduce the figure for the twelve months ended February 28, 1942, for net operating revenue of $6,361,247 [fol. 10378] based upon the 1941 tax rates to a figure approximating $4,526,618. That figure, as I answered before, is less than the figure I call minimum necessary to maintain credit position of $5,382,677 as also shown on Chart No. 45 of Exhibit No. 253. It would seem that if the tax rates are to have the effect already mentioned, then one of two things must be true if the company is going to reach this figure I caption "Minimum necessary to maintain credit position" of $5,382,677. Those two things would be either an increase in gross revenue, taking into consideration new tax rates, an increase in gross revenue sufficient, after the new tax rates, to allow a net operating revenue figure equal to $5,382,677 or an increase in rates to help compensate for that difference or a combination of the two, namely, an increase in rates plus some increase in gross revenue and the only purpose of Chart No. 45 in this exhibit was to indicate that Treasury proposals and the law as it is finally developed are already having a marked effect upon this company to reduce its net operating revenue below the minimum necessary to maintain credit position and, therefore, some action either by way of management to increase gross revenue through development of further business or some rate adjustment—

Q. (Interposing) Upward?

A. (Continuing) upward or a combination of the two.

Now, I had no thought in mind as to what plant expenditures, in addition to what have already been made [fol. 10379] might be, because, as I see it, that figure will be determined solely by the consuming market in the territory served by this company and certainly the management would not add to plant to any greater extent than they thought they had a market developed to require such service.

Now, so far as any assumption that increases in gross revenue worked in direct proportion to increases in plant account, I have made no such contention. I have not studied the matter. I am merely showing that the influence of these taxes is such as to create a real problem for this and all other companies. I have not made the calculation for all other companies. I have made it specifically on the company in question.

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[fol. 10380] Recross Examination.

By Mr. Littman:

Q. Well, let's see how accurate it is. You have not told us anything about the capital additions, have you?

A. With the exception of the $6,500,000 approximately that was estimated for the ten months from February 28, 1942, to December 31, 1942, as shown in Chart No. 8 of Exhibit No. 253.

Q. With that exception, you have not portrayed the actualities of the situation with respect to capital additions that may be required to produce this additional gross revenue, have you?

A. No, I made that clear in my answer.

Q. Now, you know, don't you, that such capital additions as may be required to produce such gross revenue will immediately have an effect upon the calculation of the taxes, wouldn't they?

The Witness: May I have that question read, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: Can we state that the other way around, that any increases in gross revenue will immediately have an effect upon the taxes?

By Mr. Littman:

Q. No, I am not talking about increases in gross revenue. I am talking about increases in your capital account. Doesn't the increase in your capital account change your [fol. 10381] taxes?

A. Well, so far as the revenue account is concerned, we are talking about the gross revenue and the excess profits and normal and surtaxes so you will have to develop your question a little further, it seems to me.

Q. We are talking about the extra allowance that the Treasury Department gives you by reason of your increased capital investment.

A. Assuming you use the invested capital credit as a basis for calculating taxes, is that right?

Q. Assuming you use either method, any method, as a matter of fact.

A. If you use the average earnings basis, I do not see that it has anything to do with it. You have got only two alternatives under the present revenue act and that is either to use your invested capital as a basis for taking your credit or else using the average earnings basis.

Mr. Wheat: You are speaking now of the excess profits tax laws, are you not?

The Witness: Yes, that is correct and also about normal and surtaxes.

By Mr. Littman:

Q. Is it your understanding, Mr. Coffman, that the Treasury Department makes no allowance for increased investment under the average earnings method? Is that your understanding of the tax laws?

[fol. 10382] A. No, that is not my present understanding but what I am saying is that, so far as any material difference is concerned, I believe it would come mostly on the basis, if you selected as your credit calculation the invested capital method, there will be some allowance, but I do not believe, although I have not made the calculations, that the amount of difference in tax would be so great.

Now, maybe I am wrong but I do not think I am.

Q. You have not made the calculations, have you?
A. No.

Q. How do you know whether you are right or wrong or how close to right or wrong you are?

A. From the calculations I have made heretofore in applying the various rates.

Q. Made where before?

A. That I have made in other connections which have given me some knowledge of how the tax actually works.

Q. Let's assume $6,000,000 of additional capital investment and tell us what the tax rate would be under the Morgenthau proposal?

A. I do not still get your point, Mr. Littman. Wherein will the calculations be any different than I have shown on page 3 of table supporting Chart No. 45 and on page 2 of table supporting Chart No. 45?

[fol. 10383] Q. Suppose you show us where on any of these tables you have given any credit by reason of capital additions. That will most certainly be required to produce this additional revenue and that will be required under your testimony.

The Witness: Will you read that question, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: No, I have never said that I made any such allowance for capital additions. I answered that question very definitely in your last series of questions.

By Mr. Littman:

Q. But such an allowance would be made, wouldn't it, under the tax laws?

A. Yes, it would be but I think I answered your question on Saturday very directly and I believe the record will bear me out that I took these assumed increases in gross revenue without making any allowance for additional capital expenditures that might be necessary to create that additional gross revenue.

Q. Now, on your redirect examination, you made some references to Chart No. 26 on which is shown the invested capital as of February 28, 1942, in the amount of $77,830,535 and which also shows that the earnings required to maintain credit position, according to your testimony, amount to $5,382,677.

Now, I thought we understood each other at the conclusion of Saturday's session but the redirect examination, [fol. 10384] I am afraid, has confused me again. I would like to have you enlighten me whether this $5,382,677 figure would go down if the Commission were, for example, to find that there is a write-up on the company's books in the property accounts amounting to $1,100,000?

A. Yes, it would and that is not inconsistent with anything I have said here this morning, Mr. Littman, because, if you will recall, I said that if the $77,830,535 is an accurate figure, then that is what the investors have put into the business and would expect a return on.

Now, if there was a write-up in the books, then obviously they did not put in capital to that amount so we will make an adjustment and that will influence the figures downward. There is no inconsistency and I have not changed my statement at all.

Q. Now, your responses to some of Mr. Wheat's questions on redirect examination merely emphasized, did they not, what you believed [the] be the realistic approach, namely, for one, amortizing cash in the bank and giving a return on it provided it is reflected in invested capital, isn't that right?

A. Well, I would like to answer that a little differently than you put the question because amortization has a rather particular meaning and what I was trying to do, in answer to Mr. Wheat's question, was merely point out that if the $6,500,000, in round figures, of net working [fol. 10385] capital is to be nonexistent, we must then first find out how it is to be taken out of the total invested capital unless we could show that there was a write-up to exactly the same amount which had no justification then I can see that you would eliminate that amount.

Assuming for the moment that there is no inaccuracy in the total invested capital of $77,830,535 which includes the $6,500,000 of working capital, then I say that, from a managerial and sound business policy point of view, that the elimination or reduction of that working capital would be used to buy in the notes and early maturity bonds.

Q. Assuming that the excess working capital is paid out to the stockholders by way of dividends, then you would start reducing the earnings required from the top, namely, the 12 per cent capital rather than the bond capital, isn't that right?

A. I think I stated in my answer that, so far as sound business policy is concerned and a realistic point of view, you would first consider the funded debt because it has maturities and if they are not met or the interest on them is not met, you could be in default. It could be used for preferred stock purchase, for example, or it could be used for dividends on common stock but, if you are going to make such statements, I doubt very much whether the company could take 6½ million of dollars and distribute [fol. 10386] it as dividends, bringing its net working capital down to practically a negligible figure without ... ving to encounter some difficulties from bond holders and preferred stockholders.

It just does not seem to me to be realistic to assume such basis. After all, there are $5,000,000 of maturities that are coming due in about the next 24 months and that is getting pretty close so it would seem to me, if you are going to use any of this working capital, you had better dispose of those things first.

Q. Mr. Coffman, suppose you tell me what happens when a company like Interstate Company, which has only common stock, suffers a reduction in over-all invested capital by reason of some of these matters that have been mentioned? Do you take it off the top or off the bottom or what is the effect?

Mr. Culton: We would like to know what is meant by "some of these matters"? The question is indefinite.

By Mr. Littman:

Q. Do you understand my question?

A. I think I understand what you are asking.

If you draw the distinction between companies that are financed by all common stock, there is no problem obviously, because common stock defines the entire capitalization so you have not any problem but, when you get to a company that has senior debt classified as to both bonds and

[fol. 10387] preferred stock, and particularly one that has near term maturities, you have got an entirely different situation.

Q. Mr. Coffman, I would like to have you turn to page 3 of section II of Exhibit No. 254 where you show a summary of your computations of investors' appraisal of risks of capital represented by the 153 stable industrial companies. Do you have that? A. Yes, I do.

Q. However, before discussing that page, I find that I have now located the chart in your Exhibit 253 which shows the working capital of the five natural gas companies.

A. What chart, please?

Q. Chart No. 42. A. Yes, I have that.

Q. Will you state from that chart the amount of net working capital of El Paso Natural Gas Company as of January 1, 1942? A. It is $8,781.

Q. Now, that is a solvent company, isn't it?

A. Yes, that is.

Q. Is it comparable to Panhandle Eastern?

A. Well, it is one pipe line company in the industry.

Q. Now, what is the comparable amount for Panhandle Eastern Pipe Line Company of net working capital? $6,000,000, isn't it?

[fol. 10388] A. It is $6,576,743 but, to get the comparable figure—well, it is half-way between December and February, so that is all right.

Q. It is close enough for our purposes? A. Yes.

Q. What was the net working capital of Northern Natural Gas Company as of December 31, 1941?

A. It had a deficit of working capital of $23,167.

Q. Less than nothing?

A. At that particular moment of time.

Q. And that is a solvent company, isn't it?

A. Yes, it is.

Q. Comparable to Panhandle Eastern?

A. It is another gas pipe line company in the industry.

Q. It is sufficiently comparable to be compared by you in these charts for purposes of determining and comparing investors' appraisals of risks?

A. Well, I think throughout I have drawn this distinction in regard to these companies.

I have said that an investor who was contemplating an investment in a given company in a given industry would look at the industry. I have done the same thing without saying that this company is exactly comparable or very nearly comparable or any other thing. I have just said I have gotten all of the companies in the industry upon [fol. 10389] which I could make a calculation.

Q. Now, I would like to have you refer again to page 3 of section II of Exhibit No. 254. Here you show the total indicated market value of capital with respect to these 153 stable industrial companies in total for each of the years 1937 to 1941, inclusive, do you not? A. Yes, I do.

Q. Now, what was the market value of the outstanding securities of these 153 stable industrial companies in 1937?

A. It was $22,692,237,000.

Q. Now, I note that for the year 1938, the amount is considerably less, isn't it, having gone down to $19,423,780,000. Is that correct? A. That is correct.

Q. Now, will you state the indicated market value of the capital in these 153 stable industrial companies for the year 1940? A. It was $19,871,449,000.

Q. Now, how much, in total, did the market value of those securities go down between 1937 and 1940? Give me the difference between the two figures.

A. It went down $2,820,788,000.

Q. Now, if one investor owned all of these securities and had purchased these securities in 1937 at the market value [fol. 10390] shown, then he would have lost, in market value, the amount of $2,820,788,000 had he held on to those stocks during those years?

A. Well, we would say that he had an indicated paper loss.

Q. Well, he would deduct it from his income tax, wouldn't he?

A. No, not unless he sold them, he wouldn't. He would like to.

Q. If he sold them in 1940, he would suffer that loss?

A. Yes, then he would take them or deduct them as a capital loss.

Q. What were the earnings available for capital, according to your chart, for the year 1937—withdraw that—what were the earnings available for capital during these same four year, 1937 to 1940?

A. For each year, you mean?
Q. No, I mean the total.
A. Well, for each of the years or just 1937 and 1940?
Q. Through—.
A. (Interposing) All right. In 1937, the earnings available for capital amounted to $1,550,677,000; in 1938, $1,011,742,000; in 1939, $1,315,905,000; 1940, $1,418,677,000 and, in 1941—
Q. (Interposing) We are not going to include 1941 for [fol. 10391] our purposes here.

The total for the four years is $5,297,001,000 of earnings during those four years?

A. The total for the four years 1937-1940, both inclusive, of earnings available for capital was $5,297,001,000.
Q. Now, when you made your study of the earnings-price ratios of the securities of these companies as summarized in your Chart No. 11 of Exhibit No. 253, you did not take into account the loss in market value over this period of $2,820,788,000, did you?
A. Well, I do not quite follow that. I took the total indicated market value for each year and the total earnings available for capital for each year so that you have the relationship of earnings to price, whatever the price was, or, put it the other way around, earnings to indicated market value, whatever it was.
Q. What we are trying to get at here, Mr. Coffman, is the true earnings over this period, taking into the reckoning the loss by the investors over the four-year period in market value of $2,820,788,000. You have not made any calculation, have you, that reflects any such loss in market value?
A. I have not made any accumulated total for a four- or five-year period, no, but in Chart No. 11 of Exhibit No. 253, the section captioned, "Investors' Appraisal of Risks of Capital" is as shown for each of the years which is the [fol. 10392] relationship of the earnings available for capital to the indicated market value of capital.

Mr. Wheat: During those respective years?

The Witness: During those respective years.

By Mr. Littman:

Q. I know that is what you did. Now, suppose you deduct the $2,820,788,000 of loss in market value for the four years from the earnings for those four years of $5,297,001,000 and state the amount of the difference?

A. The difference would be $2,476,213,000.

Q. Now, that is slightly more than 10 per cent earnings over the four years on the original market value in 1937, is that right?

A. Well, yes, it would be over 10 per cent.

Q. Just a little over 10 per cent?

A. Well, it would be something over 10 per cent. I mean it is the relation of $2,476,000,000 to $44,692,000,000, so it is obvious that it is more than 10 per cent.

Q. With an indicated earnings of approximately $2\frac{1}{2}$ per cent per year on the basis of the original market value in 1937, is that right?

A. That is the correct arithmetic.

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[fol. 10394] By Mr. Littman:

Q. It is apparent, Mr. Coffman, that the investor, even in these 153 stable industrial companies, has been taking it on the chin for the past four years, hasn't he, in so far as the market value of the securities is concerned, at least to [fol. 10395] the tune of $2,820,788,000?

A. The best indication, in my opinion, of what is happening is exactly as shown in Chart No. 11, if you will look at the indicated years, and that shows that the investors' appraisal of risks of capital has gone up so, in 1941, it was approximately 8 per cent.

Q. And one of the elements that brought this swing upward was the reduction in the market value of these securities, wasn't it?

A. You said one of the elements, did you?

Q. Yes, one of the elements.

A. That is correct. That was one of the elements. Another element, however, was that earnings showed a proportionately less decrease.

Q. There are two elements. I named one and you named the other?

A. That is correct. It takes the two of them to get at the result.

Q. Kind of fifty-fifty?

A. I do not know about the fifty-fifty but there are two elements.

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[fol. 10399]

P. McDonald Biddison a witness, having been previously sworn, resumed the stand and testified further as follows:

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Recross Examination.

By Mr. Littman:

Q. Mr. Biddison, will you please turn to page 3 of Exhibit No. 251? I call your attention to lines 8, 9 and 10, which deal with the allocation of Account 759.112 under "Transmission Expenses-Operation", entitled, "Measuring and Regulating Stations Labor". This exhibit shows the pro forma consolidated expenses for 1941 adjusted for the full year's costs in Column B before allocation to be $60,230.64. Am I correct in understanding that your basis of allocation in this particular account is stated in Column C as follows:

"Expenses of equipment used exclusively for non-regulated sales allocated thereto and balance allocated to regulated sales".

[fol. 10400] Will you explain the meaning of that and tell us how those ratios were obtained?

A. The meaning of that is that since there [as] some of those stations which are used exclusively for the measurement of sales which are not subject to regulation, that the expense for measurement and regulating station labor attributable to those stations is to be allocated to non-regulated sales.

* * * * * * * * * *

Q. Briefly, how did you make your determination or segregation of the expenses of equipment which you claim are used exclusively for non-regulated sales?

A. Mr. Littman, I did not make it. I gave the directions under which the allocation was to be made. As has

been repeatedly explained, the work was done by Mr. Spacek.

Q. You gave him no further instructions with respect to this particular account than those which are set forth in Column C which I read, is that a correct statement?

A. No, sir, that is not a correct statement. He was furnished with a copy of my letter of April 8, 1942, which has been incorporated into the record in this case and, in connection with the testimony of Mr. Spacek, the instructions in my letter of April 8, 1942, embody completely and wholly all the instructions which I gave to Mr. Spacek. [fol. 10401] Those instructions are condensed in Column C of Exhibit No. 251.

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Q. Do you know what particular equipment is used exclusively for non-regulated sales or would that also be found in Mr. Spacek's working papers?

A. I know, in general, what it is but specifically, I couldn't enumerate it but the details of it are set out in Mr. Spacek's working papers.

Q. Suppose you state generally, then, your understanding of the particular equipment used exclusively for non-regulated sales?

A. Now, the items we are referring to at lines 8, 9 and 10 on page 3 of Exhibit No. 251 relate to measuring and regulating station labor. The portion which I have instructed in my letter of April 8 to be assigned to be non-regulated sales is that portion of measuring and regulating station labor required in the operation of the measuring and regulating stations used exclusively for servicing of non-regulated sales. The customers to whom non-regulated sales are made are listed in my letter of April 8. [fol. 10402] Q. Is it correct to say, generally, that the expenses that were allocated to non-regulated sales in connection with this account was the labor with respect to measuring and regulating the gas when it left the main line and was carried exclusively to the direct industrials. Is that a correct statement?

A. Well, it measures and regulates it upon delivery to these customers.

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Q. In other words, you did not intend to include any of the expenses of this character incurred in connection with measuring and regulating the gas during its flow from the well through the field lines and gathering lines and main lines until the point was reached where it was devoted exclusively to industrial sale?

A. No, sir, I did not. That is a very small fraction of total regulating and measuring station labor.

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[fol. 10403]. Q. Whatever the percentage is, you did not make any allocation during that part of the flow, did you?

A. No, sir, I did not.

Q. Now, you used the same description, to-wit, "Expenses of Equipment used exclusively for Non-Regulated Sales allocated thereto and the balance allocated to regulated sales", on page 3 of Exhibit No. 251 in connection with a number of other accounts, to wit, Account No. 759.122, "Measuring and Regulation Station Supplies and Expenses"; Account No. 761.2 "Measuring and Regulating Station Structures"; Account No. 762.22, "Measuring and Regulating Station Equipment."

Have I named all of the rest of the accounts on that pages that were allocated on the same basis?

A. Yes, sir.

Q. And your responses to my questions would apply equally to those accounts, would they not? A. Yes, sir.

Q. Now, let's look at page 5 of Exhibit No. 251—well, just a minute, before doing that, before leaving page 3, I call your attention to line 3, Account No. 758, "Supervision and Engineering". You have recommended that the basis of allocation be as follows, as shown in Column C, "Composite Percentages of Total Other Transmission Expenses as Allocated", have you not?

[fol. 10404]. A. Yes, sir, that is correct, and that means that is to be allocated in the proportions that are found in line 33 after the items preceding that line in transmission expenses have been allocated.

Q. Now, the allocation of that particular account reflects the allocations of the other accounts under transmission expenses, does it not?

A. That is what I tried to say just previous to your question.

Q. And, therefore, of course reflects the same method which you have described with respect to these last three or four accounts we have discussed, it naturally follows, does it not?

A. As to the proportion assignable to them, yes.

Q. Yes. Now, will you please turn to page 5. In line 5 there is a very large expense account under the heading, "Depreciation, including amortization—other physical depreciable property", in the amount before allocation of $2,238,589.81. Now, as is shown by this exhibit, you did not allocate any of that depreciation expense to the unregulated sales, did you?

A. Not of that particular figure but I have allocated some of the depreciation expense against non-regulated sales.

Q. Well, that, of course, appears in other lines, but I am talking about line 5, "Other physical depreciable [fol. 10405] property" in the amount of $2,238,589.81.

A. I directed that that be allocated to regulated sales as shown in Column C and it has been so done.

Q. Yes.

A. Now, I would like to point out, Mr. Littman, that what I have directed to be done in this Exhibit No. 251 is to allocate costs between two classes of business. I have done that because, in the Colorado case, that is, involving the three companies, the Commission, in substance, stated that it should be done and criticized some of the companies in that proceeding because they had not made an allocation of costs.

Now, all Exhibit No. 251 purports to be is an allocation of costs. It does not purport to be the final solution of this matter of the relative charges between the two classes of business but it is the allocation of costs which is a prelude to that determination and I think requisite for that determination.

Q. Well, Exhibit No. 251 reflects the manner in which you, in your opinion, believe the allocation of costs should be made, doesn't it?

A. Yes, when you go to allocating costs and that is all this purports to do, is to allocate the costs. I think there is another step necessary after you have allocated the costs. I have not carried out the other step but it is a [fol. 10406] matter of business judgment as to how much of profits of the one class of business ought to be paid to the other class, as a matter of fairness and equity, in business judgment.

Q. Let me see if I understand your last answer. Are you now referring to the allocation of return?

A. If you take some of the profits from the non-regulated business and credit to the costs of the other business considered as a rental charge for the privilege of using the facilities, you can consider that it has contributed to return and to depreciation.

Q. I am sorry. I do not quite follow what you have in mind, Mr. Biddison. Maybe if you would explain that in a little different way I might understand you better.

A. On page 1 of Exhibit No. 251 it is shown that before the modification from proposed new income tax rates at line 42, there is available from these non-regulated sales $651,766.70. Before the income tax of $349,062.28, there was available for income tax and return a little over $1,000,828.98. I think it would be entirely fair and just, in line with what Mr. Goodman commented last week, that some portion of that little over a million dollars should be made a charge against the non-regulated business and substantially paid to the regulated business as a fee for the privilege of using the equipment through which delivery of this non-regulated business is effected. In [fol. 10407] other words, I think you should first find out how much this non-regulated business is costing and then make some division of the profits from it.

Now, what that division should be, I think is a matter of business judgment but, in fairness, I think there ought to be some division of it in spite of the fact that the language in the Colorado case does not indicate that to be the view of the Commission.

Trial Examiner: What language is that?

The Witness: You will find that language in the decision with reference to the Colorado-Wyoming case, Mr. Examiner. I do not find this decision an easy one to understand.

Mr. Culton: You understand that the method which you have just described would be an allocation of return as return is understood by you?

The Witness: It would be an allocation of return and of depreciation.

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The Witness: In a rate case, I understand the earnings on rate base.

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Mr. Culton: (Interposing) That is the Opinion of the [fol. 10468] Commission?

The Witness: Of Opinion No. 73 involving Canadian River Gas Company, Colorado Interstate Gas Company and Colorado-Wyoming Gas Company, page 59 with reference to the Colorado-Wyoming Gas Company, it appears that the Commission's staff had prepared an allocation which the Commission did not adopt with respect to this particular company. The Commission stated and I quote:

"The Colorado Portland Cement Company, the principal main line industrial user, is curtailed regularly during system peak days. Its demand on the system peak day is, in our opinion, a proper measure of its proportionate share of demand costs than its highest off peak demand."

I judge there is a word omitted there and I think it probably should have read, "a more proper measure."

Now, I gather from that, if it does not create demand on the peak day, it does not bear any proportion of demand charges.

Mr. Culton: That is, on the Commission's method?

The Witness: Yes, sir.

Now, it is indicated in that opinion that there were some other considerations and some other principles involved in connection with the situation on the Colorado Interstate Gas Company but I do not know whether the Commission has told us, in that opinion, what they did do [fol. 10409] in the premises and I do not know from the tabulations they show whether they did what they said they did or not. I cannot tell.

I should like to add in explanation of what I have previously said that when you make some division of this $1,000,828.98 available for income tax and earnings on the unregulated business, that that necessarily involves a reallocation of income tax between the two classes of business.

By Mr. Littman:

Q. Referring again to page 5 of Exhibit No. 251, is it true that these expenses of $2,238,589 shown in line 5 include the expense for depreciating company's wells?

A. I think not. That is taken care of in the charges for depletion, wells and leases.

Q. Is it your testimony that the depreciation applicable to wells should be allocated, in part, to the non-regulated sales? A. Yes.

Q. Mr. Spacek is not here but I am going to ask you whether you could make a further check for us during the coming recess and tell us for certain whether the depreciation on the gas wells is included in this $2,238,589 figure or not? Do you have sufficient information here to make a check on that?

A. I am not sure whether I have or not. I will try it, though.

Q. Very well.

[fol. 10410] A. You see, these figures are not my compilation but I think maybe I can get a check on that anyway.

Q. We have all of Mr. Watkins' exhibits here and perhaps, during the next recess, we can make sure of the facts.

What is your understanding as to well lines. Did you recommend that the depreciation applicable to the well

lines should or should not be allocated to non-regulated sales, in part?

A. I recommend that it be not allocated, in part, to non-regulated sales.

Q. Now, those well lines, of course, carry the gas that eventually reaches the direct industrials as well as the gas that reaches the regulated sales, don't they?

A. Yes, sir, they do. In that respect, they are like the main lines.

Q. Now, gathering lines fall in the same category, I take it? A. That is right.

Q. And I think it is abundantly clear now, in the record, that you have not allocated or you have not recommended that there be allocated to the non-regulated sales any portion of the depreciation expense of main lines. Is that right? A. That is correct.

Mr. Culton: That is if the allocation is based on cost?

The Witness: That is correct and that is all I am allo- [fol. 10411] cating here, is cost.

By Mr. Littman:

Q. Now, naturally those mains carry all of the non-regulated gas as well as all of the regulated gas, do they not? A. Certainly, certainly.

Q. And, as a matter of fact, don't they carry the non-regulated gas on peak days to a certain extent?

A. There is no capacity provided in Panhandle Eastern's system for the carrying of any of these non-regulated sales and there has been no capacity available for them above the requirements for regulated sales, requirements and commitments.

Q. Isn't it a fact that on the peak day of the past winter, 1941-1942 winter, as well as on the peak days of previous winters, these main lines have, in fact, carried unregulated gas?

A. During January, 1942, the Panhandle Eastern system experienced its greatest peak day. The system has a capacity with 500 pounds maintained at the outlet of compressor stations of substantially 250 million cubic feet per day available for sales.

On January 7, 1942, the maximum sale in the history of Panhandle Eastern was experienced in the amount of about 254 million cubic feet. On this day, the input for sale was a little bit less than the 250 million cubic feet of capacity and the 500 pounds discharge pressure at com- [fol. 10412] pressor stations was not quite maintained. Sales to the direct industries were curtailed so that, upon this day, out of a total requirement for direct industrial sales including the Anchor-Hocking plant in Indiana of about 25 million cubic feet, slightly under 9 million feet was delivered, the figure for delivery was 9,860,000. As against this actual delivery on that peak day, there was a curtailment of non-direct sales to interruptible consumers of 4,242,000 cubic feet; approximately 10 million cubic feet was taken out of line storage, an amount greater than the delivery to direct industrial consumers and the Detroit market curtailed its use below the 125 million cubic feet which Panhandle Eastern is obligated by contract to devote to their service, which is substantially the amount of their previous peak takings by 15 million feet, substantially—

Mr. Chamberlain: (Interposing) May I ask right there this question— You say that that was their previous peak, 125 million?

Mr. Culton: Previous peak take, I think he said.

Mr. Chamberlain: Yes, I thought he said that.

The Witness: On March 18, 1941, Detroit took, in therms, 1,273,888 therms of gas having a heat value on that day of 1,016 B.t.u.'s and that is the equivalent of just a trifle over 125 million cubic feet.

On the succeeding day—

[fol. 10413] Mr. Culton: (Interposing) That is, the January date?

The Witness: January 9 or, specifically, on January 8.

Mr. Wheat: 1942?

The Witness: 1942, there was served to direct sales, 7,619,000 M.c.f.'s. There was curtailment of indirect sales

to interruptible customers, 6,590,000 feet; an additional 5,000 feet was taken out of storage and Detroit again, upon that date, failed by about 15 million cubic feet to take the 125 million which Panhandle is obligated to place at their disposal.

Mr. Lee: May I interrupt you there, Mr. Witness, pardon me. When you say "Detroit failed to take the amount allowed under the contract," you do not infer that there was anything in the contract that allowed them to take that lesser amount, do you, or that prohibited them from taking that lesser amount?

Mr. Culton: No, he is just talking about required capacity, Mr. Lee.

Mr. Lee: I understand but the language he used failed to state that and I thought it might leave a different inference in the record.

Mr. Culton: I think, as a matter of fact, the company needed far more gas on those particular days and they exercised their rights under the contract to manufacture gas.

Mr. Lee: That is all I want to bring out, the fact that the word "failure" does not raise any issue—

[fol. 10414] Mr. Culton: (Interposing) By "company," of course I mean Michigan Consolidated.

Mr. Lee: Yes.

The Witness: No, I mean merely they were exercising their own judgment.

Mr. Lee: And their contractual rights?

The Witness: Yes, they did not take the amount of gas which, under those same contracts, Panhandle Eastern is obligated to have available for them.

Trial Examiner: Well, if they had taken the amount that they were entitled to take, could you have served Anchor-Hocking and other industrials those days?

The Witness: No, sir, if they had taken the 15 million additional which they could have taken under their contract and which Panhandle Eastern is obligated to furnish, if

they desired it, that 15 million itself would have exceeded on the 7th, by about 6 million feet the amount that was delivered to the direct interruptible business and on the 8th, that 15 million exceeds by about 7,400,000 the amount which was delivered to the direct interruptible business.

Now, taking the curtailment of the indirect interruptible customers on these two days, the amounts taken out of storage on these two days and the amount by which Detroit's use failed to reach the contractual obligations, we have 20,282,000 on January 7 and 18,971,000 on January [fol. 10415] ary 8 by which Panhandle Eastern Pipe Line Company lacked any capacity for service to direct industrial customers.

Mr. Lee: May I ask another question, if you will pardon me for breaking in here but just to clarify this, is that last type of gas that you just spoke of, that last type of customers, rather, is that what is characterized as "dump" gas?

The Witness: No, Mr. Lee, that is not quite what you would call "dump" gas. I do not think Panhandle Eastern has any sales that you can truly call "dump" gas sales.

Mr. Lee: Isn't it true that the type of customers that you last mentioned there and the gas sold to them is gas that primarily is sold to other customers and sold to these customers last mentioned when the other customers fail to take their requirements under their contracts?

Mr. Culton: Suppose you give your own definition of interruptible gas. I think you are both looking at it along the same lines but I think the witness looks at it from an engineering viewpoint and you look at it from a lawyer's viewpoint.

The Witness: There are two classes of gas we are discussing here and it so happens, in this particular instance, the two classifications fit identically the same customers.

Gas is sold directly to the customer by Panhandle Eastern. It does not go through any intermediary. In that [fol. 10416] sense, it is a direct sale. All those contracts are on an interruptible bases, that is, whenever the ca-

pacity of the system is not such that gas can be made available to these customers, service to them is curtailed.

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The Witness: It is a secondary service.

Mr. Lee: That is what I am getting at and that being true, let's take the reverse of the situation you are stating here. As I understand you, you are stating the situation where, because of the fact that the Detroit company, Michigan Consolidated Gas Company, did not take the maximum it was entitled to take under the contract, that you, therefore, had an excess of gas or you had 15 million cubic feet of gas which you could sell elsewhere.

Now, let's take the reverse of that. If the Detroit company had taken all they were entitled to take, you would not have had that gas to sell elsewere, would you?

The Witness: No, sir, and they would have to cut off 17 million feet additional on the 7th of January and nearly 19 million on the 8th.

Mr. Lee: So there is nothing contractually wrong with the Detroit company and it is always contemplated that the contractual customers shall have first call and these customers' contracts you are discussing now will be filled if and when the first call allows them to be filled, is that correct?

[fol. 10417] The Witness: That is correct.

By Mr. Littman:

Q. Would you say, Mr. Biddison, in view of your testimony thus far given that the direct industrial business of Panhandle Eastern is, in reality, a by-product of its main business, to-wit, its regulated business?

A. No, I do not think it is in any sense a by-product. It is a corrolary business but I do not think it is a by-product business.

Mr. Culton: It is more an incremental business, is it not?

The Witness: Yes.

By Mr. Littman:

Q. You have proceeded in your recommendation of allocation, have you on an incremental basis?

A. No, not entirely so, Mr. Littman.

Q. Well, is it something which fairly closely approximates the result that would be obtained by allocating the unregulated business on an incremental basis?

A. I do not know how closely it would approximate it, Mr. Littman. I did not attempt to do it in that fashion and, if you approached it in that fashion, I do not know how much different your answer would be when you got through. I did not think of it in that fashion when I gave the instructions.

Q. Well, if you had allocated on an incremental basis, your would not have allocated any part of the main line ex- [fol. 10418] pense to the unregulated business as you have done here. I mean, you do the same thing there as you have done here.

A. I think I would allocate some of that transmission expense even if I approached it on an incremental basis. I do not believe, though, if I approached it on an incremental basis I would have as much cost assigned to this non-regulated sales as I do have as a result of Exhibit No. 251 but, not having gone into it, I cannot say how much different it might be.

Trial Examiner: I suppose counsel for the company will agree that, unless the Commission should determine that the Panhandle Eastern Pipe Line Company is making present earnings in excess of a fair return, that any allocation such as is contemplated by Exhibit No. 251 would be of no effect?

Mr. Culton: That is right.

Mr. Wheat: We would take it, Mr. Examiner, that it would be an entirely moot point and that the entire business problem, as between these customers, would be something to be handled by management.

By Mr. Littman:

Q. Well, let's look at line 8 of page 5 where you show the ad valorem taxes before allocation in the amount of $633,270.40 or perhaps I should say where that amount

is shown. Am I correct in understanding that it was your recommendation, as reflected here, that none of these [fol. 10419] ad valorem taxes applicable to any of the property other than that property which is used exclusively for non-regulated sales should be allocated to the non-regulated sales?

A. That is right. I think it so states in Column C.

Q. Now, aren't ad valorem taxes paid on wells and certain other production system property which property produces the gas which is sold to the unregulated market, as well as the gas which is sold to the regulated market?

A. There are production taxes in the nature of severance taxes which, in general, in producing fields have replaced the ad valorem taxes on property of that nature. As to the specific build-up of this $6[illegible],270.40, if there be any of that which is a tax on wells, that portion should be allocated back against production property before making the allocation as between regulated and non-regulated sales.

Q. Don't you know whether any of these ad valorem taxes were actually levied against the wells?

A. No, I do not at this time.

Mr. Cullon: You would have to know how many wells were needed to handle the interruptible over and above what was needed to handle the firm, wouldn't you?

The Witness: No, Mr. Cullon. Whatever taxes were on these wells should be allocated against production property and then split between regulated and non-regulated business in a proportion that the quantities of sales bore to the total.

[fol. 10420] By Mr. Littman:

Q. In other words, it would be done on an M.c.f. sales basis as you allocated it on page 2, is that right, generally?

A. Yes, that portion of it would be so allocated.

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Trial Examiner: What is the total volume of non-regulated sales by percentage, Mr. Biddison, roughly?

The Witness: That is shown on page 1. The regulated sales constitute 86.8 per cent of the volume and the non-regulated sales 13.2 per cent of the volume.

Trial Examiner: You said early in your testimony, as I recall it, that there were various methods of allocation to deal with the factor that you have treated in Exhibit No. 251. Is that correct? I think you said that various experts might consider the problem and, by a different process, arrive at approximately the result that you had shown in Exhibit No. 251.

The Witness: Yes, I believe I stated ~~I thought they~~ could go through some variation in detail and get approximately the same result.

Trial Examiner: If you are selling 14 per cent of your output to a market that is not subject to the regulation of the Commission under the Natural Gas Act. How would [fol. 10421] it be to charge 14 per cent of the total capital investment in operating costs to that class of business?

The Witness: Well, in general, Mr. Examiner, the result of that would be that the natural gas pipe line companies would cease the sale of gas on these interruptible contracts which, in general, bring comparatively low prices and their earnings would thereby be reduced and there would be no profit from that business to use as a credit against the cost of transacting the regulated business. That would be the general trend of it.

Mr. Culton: Suppose these direct sales were firm sales? Then would there be a greater reason for allocation? Instead of the sales being interruptible sales, suppose a considerable portion of the sales were direct sales and on a parity with sales for resale?

The Witness: If they were firm sales, there would be, I think, just as much reason for an allocation of the cost also. You would not have the same costs if they were firm sales. Neither would you have the same low price, if they were firm sales.

Mr. Lee: Aren't they, to all intents and purposes which they are characterized as interruptible, in effect, firm sales?

The Witness: No, they are not and they have been interrupted.

[fol. 10422] Trial Examiner: You are talking about the Panhandle system, of course?

Mr. Lee: That is right.

Trial Examiner: Are you familiar with the iron works at Pueblo served by the Canadian River line?

The Witness: With which?

Trial Examiner: The Colorado Fuel & Iron Company works at Pueblo, Colorado?

The Witness: No, sir, I am not familiar with them, Mr. Examiner.

Trial Examiner: You probably noticed in Opinion No. 73 that more than half of the gas distributed by the Colorado Company goes to the Colorado Fuel & Iron Company, did you not?

The Witness: I noticed that a very large percentage was distributed so. I do not remember the percentage but I know it was a large percentage.

Trial Examiner: And you probably noticed also in the Opinion that the statement was made that a prerequisite to the construction of the line was a firm contract with the Colorado Fuel & Iron Company and with the Public Service Company of Colorado?

The Witness: Yes, sir, and I am also impressed with the fact that that pipe line has some capacity in it now and always has had that is useful for no other purpose than the delivery of gas to that customer.

[fol. 10423] Trial Examiner: And that that line specifically is a 16-inch main, going directly to the Fuel & Iron Company plant?

The Witness: I do not recall the size of the main going to their plant but, in the main line of the Colorado Interstate Company, it is my impression from what I have read of the record and what I have known of their

operations, they have capacity in their main line system for the delivery of gas on peak days to that customer.

Trial Examiner: So you recognize the broad distinction between the circumstances of the Panhandle system and the Canadian system?

The Witness: Yes because, in the Colorado Interstate system, their capacity is provided for that customer, not for his entire requirement but for at least a portion of it. In the Panhandle system, no capacity is provided. In the Panhandle system, no capacity was contemplated. In the Colorado system, capacity was contemplated and was provided.

Now, the Panhandle system, in that respect, is comparable, as I understand the case, to the Colorado-Wyoming system. In the Colorado-Wyoming system, it is their practice to cut off that direct industrial sale and the Opinion recites the fact that they do it. That is the practice of Panhandle Eastern.

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[fol. 10424] By Mr. Littman:

Q. Mr. Biddison, are you prepared now to give us the requested information with respect to the depreciation on wells and the ad valorem taxes on wells?

A. Yes. During the recess, I have refreshed my memory as to how this matter was handled and while the amount of depreciation, at line 5 on page 5 of Exhibit No. 251 includes the depreciation upon wells, I directed it to be applied entirely to regulated sales because, like the main lines of this company, the requirements for wells are fixed by the demand of the regulated business.

Now, as to the item of ad valorem taxes at line 8 on page 5 in the amount of $633,270.40, while there are included in that item some small amounts of taxes that might well be allocated upon a different basis, the investi- [fol. 10425] gation that I made at the time these instructions were given indicated that the amounts of such taxes were trivial and that for a compilation of this sort, since exactness was not obtainable in any event, that substantial justice would be done by the application of the formula shown in Column C.

Q. Is my understanding of your answer correct, that you feel that the depreciation expense of wells is applicable entirely to regulated sales?

A. Yes, sir. The number of wells and, therefore, the value of wells and, therefore, the amount of depreciation on wells, is fixed by the peak day requirements. The peak day requirements are fixed by sales for resale which are the regulated sales.

Q. Aren't those wells used to furnish gas to the unregulated customers?

A. Yes, sir, those same wells furnish gas for unregulated customers. The same well lines transport gas for the unregulated customers. The same gathering lines transport gas for the unregulated customers. The same main line transports gas for the unregulated customers. The same field measuring stations measure the gas for both classes of customers. The same compressor stations handle gas for both classes of customers.

Q. It kind of looks like the non-regulated gas is getting a free ride all the way from the bottom of the well to (fol. 10426) the lateral line used to serve them exclusively, doesn't it?

Trial Examiner: In the preparation of your Exhibit No. 231, I suppose you bore in mind the Commission's distinction between fixed costs and variable costs?

The Witness: No, Mr. Examiner, I did not classify precisely on that basis. In this Opinion No. 73, the Commission spoke of classifying those costs which were variable costs as being commodity costs and those costs which were reasonable stable in amount, that is not variable, as being demand costs.

Now, I recognize that that is a common method by which to fix a schedule of rates. I differ from that scheme in the allocation of costs in some of the details because I know from experience that some costs which are variable are still attributable to demand and some costs which are not variable are still attributable to commodity so while the use of the two classifications of costs as between fixed and variable, may be right and proper in the design of a rate structure, it may fail to do justice in an allocation of costs because fixed costs are not necessarily all demand

costs and variable costs are not necessarily commodity costs.

By Mr. Littman:

Q. Mr. Biddison, is my understanding correct that what you have undertaken to do with respect to this allocation study is to submit your interpretation of the Commission's [fol. 10427] Opinion in the Canadian River case and apply it to the facts here in this proceeding?

A. That is pretty close to it, Mr. Littman.

Q. Well, suppose you restate it.

A. But I have to acknowledge that I cannot thoroughly understand the Commission's procedure in that Opinion No. 73. I have followed that Opinion, as I interpret it, as far as I think it be right and proper to follow it but I make the distinction between the two methods of allocating these costs as to whether they are fixed or variable. I did not try to follow the line of reasoning. If I thought an item of cost was attributable to the amount of gas produced and transported, I assigned it to that regardless of whether it was fixed or variable. If I thought an item of cost was attributable to the provision for capacity, the provision for peak load requirement, I allocated that to that division of cost, regardless of whether it was a fixed amount or a variable amount.

Q. Is this the kind of allocation study that you would have made had you been instructed or requested to make an allocation study which reflects your own views rather than one which undertakes to interpret the views of this Commission as reflected in the Canadian River case?

A. It is made to reflect my own views. It is prompted by the fact that in that case the lack of such an allocation [fol. 10428] was a matter of criticism.

It does, in general, with the exceptions I have named, follow my interpretation of that Opinion.

Q. Now, you mentioned something a while ago about a step which you think, in all fairness, should be taken beyond those that are shown in Exhibit No. 251.

Now, is my understanding of your testimony in that regard correct that this allocation, as reflected in Exhibit No. 251, has the effect of assigning too much cost to the

non-regulated sales and that, before the matter be closed, there should be a credit back to the regulated sales of a portion of the profit on the non-regulated sales? Do you get what I have in mind, Mr. Biddison?

A. I think I get what you have in mind.

Q. Suppose you state it in your own language.

A. But I would prefer my own expression on the situation to your wording of it.

Q. Very well.

A. In this allocation, the non-regulated business has the use of certain facilities of the company without any charge being made against that business for such use.

Q. That is, such is the effect of the study reflected in Exhibit No. 251? A. That is correct.

Mr. Culton: That is because there is no cost for it?

[fol. 10429] The Witness: That is right. That is because they have not caused any costs for such use. Now, I think there should be a charge of some sort made against that non-regulated business for the use of that property. There should be a charge made in addition to the costs which it has caused.

By Mr. Littman:

Q. In addition to the costs shown in Exhibit No. 251? A. Yes.

Now, it is my idea in that connection that the place to start in handling that matter is to go back to page 1 of Exhibit No. 251 and, taking the net operating revenues at line 42, add back the $349,062.28 of Federal income taxes—.

Q. (Interposing) And the Federal excess profits?

A. (Continuing) and the related taxes which will give you a sum of $1,000,828.98, available for tax and return or tax and earnings. Then, on some fair basis—

Mr. Culton: (Interposing) Is there any engineering basis for a division, from an engineering standpoint?

The Witness: Not as an engineering matter, I do not know of any basis. As a business matter, I think there are ways in which it could be fairly decided. I think it requires some judgment based upon business experience to

make a fair allocation of it but there is a little over a million dollars, some portion of which could, in all fairness, be set aside as a charge against operations on the [fol. 10430] non-regulated sales and a credit against operations on the regulated sales.

After doing that, it would be necessary to reallocate this amount of Federal taxes between the two classes of business to conform with the new allocation arrived at, as to the revenues available for taxes and earnings.

By Mr. Littman:

Q. In other words, your statement contemplates a further allocation beyond Exhibit No. 251?

A. That is correct.

Q. Now, you used the term "some fair basis." Are you prepared to be a little more definitive about that and give us your idea as to what would be a fair basis?

A. Mr. Littman, I do not think I should be sitting in the Judge's bench on that matter. Before anybody could make a definite statement about what he thought was fair on that matter, he would have to know what the procedure was going to be in regard to the subsequent allocation of earnings between the two classes of business and, in any event—

Q. (Interposing) Pardon me, what do you mean by "subsequent earnings"? Do you mean in later years?

A. No, in the subsequent procedure in this case of allocating return as if it were an item of cost, one should know that and then, knowing that, I think that some compromise could be reached between whether the whole million dollars should be retained or what amount of it should [fol. 10431] be charged as a rental and credited to the regulated business as a reduction in expense.

Q. Now, Mr. Biddison, you have testified in many rate cases and I understand it is your opinion that the matter of this further allocation would be a matter of the exercise of enlightened judgment by those charged with the duty of making the decisions in this case. Is that right?

A. That is right, and I further think that they should have the opinion of the experienced management in coming to their final conclusions on that matter.

Trial Examiner: That is what you are here to give.

The Witness: Mr. Examiner, I am not the management of this property.

Trial Examiner: You are the expert engineer who has been advising them and testifying about allocations. That is what you are asked for right now.

The Witness: If the Examiner wants my opinion, I will give it. It is my opinion that that $1,000,828.98 should be divided fifty-fifty.

Trial Examiner: Why?

The Witness: It is just my judgment as a businessman that would be a fair allocation of it.

Mr. Littman: You mean fifty-fifty as between regulated and non-regulated business?

The Witness: That is correct. I think that would be [fol. 10432] a fair allocation.

Mr. Calton: That is a business judgment estimate, not a mathematical estimate?

The Witness: That is right. In that way, this non-regulated business has contributed half a million dollars a year towards the reduction in cost of the regulated business and if it does not contribute something, I do not think there is any justification for having the business.

Mr. Littman: Mr. Buldison, before I dismiss you, for my part, I do not think there is any evidence in this record that tells us the approximate rate at which the gas flows through the main line from Texas east and north to Detroit.

The Witness: You mean the speed per mile?

Mr. Littman: The approximate speed per mile per hour?

Mr. Culton: That would depend on how much gas is being used, wouldn't it, for one thing?

The Witness: Yes, and upon your relative pressures but, if we say that under peak day conditions—

Trial Examiner: (Interposing) On maximum day delivery?

Mr. Littman: Yes, let's take, for instance, January 7, 1942.

The Witness: I think I can give you an approximation on it.

The rate of flow would not be a constant velocity in any section of the line. To explain that, let's consider any [fol. 10433] one section between two compressor stations. Say we have 500 pounds discharge pressure at one station and, at the next station, that pressure has declined to 300 pounds.

Now, the quantity of gas, in pounds, flowing past any point in that section for 250 million a day flow would be constant but the velocity, in feet per second, would vary from the low figure at the high pressure to a higher figure at the low pressure.

Now, the mean velocity between those two points would be fixed by the mean pressure which is not the average of the two but is two-thirds of the difference in cubes divided by the difference in squares of pressure. That will be somewhere close, however, to the average of the two pressures which were 500 discharge and 300 inlet which would give 400 pounds average pressure.

That 400 pounds average pressure, being gage pressure, is about 415 pounds absolute and in the size of atmospheres that Panhandle measures their gas, that is 14.73 pounds. That is about 28½ atmospheres at the mean pressure and, at that mean pressure, you would have the mean velocity.

Now, if we consider this to be two 24-inch lines, we would have then, with 250 million cubic feet a day output, 125 million cubic feet per day in each line and, at the mean pressure, that would occupy a space of 4,400,000 cubic feet. This 24-inch line is about 23.44 inches inside

[fol. 10434] diameter and that is equal to about 1.94 feet in diameter and gives about 2.85 square feet of area.

That will give a mean velocity of about 1,550,000 feet per day or 64,500 feet per hour or about 12.2 miles per hour.

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[fol. 10435] Recross-Examination

By Mr. Chamberlain:

Q. Mr. Biddison, I understood you to say a short time ago that the peak day sales or, as I assume, the maximum day sales were fixed by the sales for resale. Do I quote you correctly?

A. No, the capacity to be provided to meet the peak day sales is fixed by direct sales.

* * * * * * * *

Q. By direct sales—what do you mean?

A. I mean by sales other than those made directly by Panhandle Eastern Pipe Line Company—

Mr. Culton: (Interposing) You mean sales for resale—

The Witness: (Interposing) I find I have misused a word. Let me start it over again, Mr. Chamberlain.

Mr. Chamberlain: Yes.

The Witness: The capacity required to meet the peak day is fixed by the sales for resale.

By Mr. Chamberlain:

Q. And you state that as an engineering matter or as the method that has been used in this case in preparing the exhibits?

A. Well, I state that as a matter of having studied [fol. 10436] the situation. I have studied the peak day situation. I have also, from time to time in the past, checked the calculations made by Panhandle Eastern in their estimates of additions and improvements to be made to meet expected demand and I know what the practice in that respect has been as regards the handling of direct sales and sales for resale.

Q. Then the capacity that is provided is only for the sales for resale? A. That is correct.

Q. Yes. Now, let us see if we can get this record clear on the different classes of industrial sales. You spoke about dump sales and suggested that there were few of those in the Panhandle system. Is that correct?

A. No, no. I was interrogated about some dump sales and I said I did not think that the sales in this classification of direct sales, which were all interruptible, could properly be called "dump" sales.

Q. I understood you to say that the dump sales were few, if any. I may have been hearing incorrectly.

A. I do not think I said that, Mr. Chamberlain.

Q. In other words, you took the position than that all of the sales were what are known as interruptible sales rather than dump sales?

A. All of the direct sales by Panhandle Eastern.

Q. All of the direct sales?

[fol. 10437] A. Yes, sir.

Q. Then, do you have some indirect sales that are dump sales or does the company?

A. The company has some indirect sales which are, I understand, interruptible.

Q. Yes.

A. I do not know of any of those sales that could properly be classified as dump sales.

Q. Are there some boiler fuel contracts?

A. There are some direct sales for boiler fuel.

Q. And those are not dump sales?

A. I would not so class them, as dump sales.

Q. You would classify them all as interruptible sales?

A. They are interruptible sales no matter who classifies them.

Q. A dump sale is interruptible?

A. Yes, a dump sale is interruptible but an interruptible sale is not necessarily a dump sale.

Q. Let's have the definition of a dump sale and let's have a definition of an interruptible sale.

A. I consider a dump sale is one which is sold at a price far below the cost of any competing fuel, sold with a desire to make some very small margin of profit over the costs incurred in rendering service.

Q. Then it must be sold far below the cost of competing [fol. 10438] fuel?

A. I would so consider it before I would class it as a dump sale.

Q. And you do not figure the dump sale one in which the vendee has the facilities for immediate change-over to another fuel?

A. It may or may not have it. I do not think that is what makes it a dump sale. My view of the dump sale is it is one which is interruptible but also one which you sell at almost any price in order to get rid of it.

Q. In other words, your conception of a dump sale is one that you are tossing on the market at a very low price?

A. Yes.

Q. The distinction between interruptible and the dump sale is more as to the price received than as to the other factors? A. Yes, sir.

Q. Now, what is the interruptible sale?

A. The interruptible sale is one in which the seller has the right to interrupt service when his facilities are required for the servicing of customers to whom he has a firm commitment.

Q. And is the interruption conditioned upon notice to the customer buying the gas?

A. Generally so. It is provided that he shall discon-[fol. 10439] tinue service when notified to do so. Quite often, however, provision is made that service may be discontinued without notification.

Q. Now, in such a contract as the Universal Atlas Cement Company or such as Anchor-Hocking, would it be possible to make those contracts so that the service might be interrupted without notice or without substantial notice?

A. I presume in the contract with a cement company or with an open-hearth outfit or with a glass company, that there would be requisite some provision about giving notice as far in advance as you possibly could.

Q. Will you please refer to your Exhibit No. 251.

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By Mr. Chamberlain:

Q. In line 4, you place the amount of industrial gas, Column B, which I understand to be direct sales, at 6,580,812 M.c.f., do you not?

• • • • • • • • • • •

The Witness: No, that is the total of those industrial sales as they were classified but, of those industrial sales, 55,203 M.c.f. to North American Refractories is a sale for resale and so classified. The balance of 6,528,609 M.c.f. is direct.

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[fol. 10444] By Mr. Chamberlain:

Q. Mr. Biddison, is there any difference in the interruptible industrial contracts which are designated as special industrial contracts and those interruptible industrial contracts which you have listed as direct, other than the fact that they are made through the distributing agency?

A. Yes.

Q. What are they?

[fol. 10445] A. There is this difference: On those direct interruptible sales when Panhandle Eastern wants them interrupted, it is under Panhandle's physical control to effect the interruption.

* * * * * * * * * *

Q. In the formula which you have prepared for use in Exhibit No. 251, you have, in effect, taken the increment theory in determining the operating costs of selling the non-regulated gas, have you not?

A. No, I did not and I have explained that I did not although I will say that the results of using the increment theory probably would produce a result not very far from what I have used. I do not know how much difference there would be because I have not worked it out under that theory.

Q. Now, there is no distinction, in so far as the direct interruptible contracts and the indirect interruptible con-[fol. 10446] tracts are concerned, in so far as the cost of selling and distributing that gas, is there?

A. I do not believe there is.

Q. No, and referring to your Exhibit No. 251 or Mr. Spaeck's exhibit, to be exact, you have a profit of two thirds of the gross revenue received from the gas, do you not?

A. I do not know what you mean by "profit."

Q. Well, net operating income, if you want to phrase it that way, prior to Federal income and excess profits taxes?

A. Prior to the Federal income and excess profits taxes, the amount available for tax and earnings is about two thirds of the operating revenues.

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[fol. 10447] Q. Now, before I go to another matter, you gave some figures as to the contribution of the Detroit company on January 7 and January 8, 1942. I read from page 9462 of the testimony in this case, of Mr. Morton:

"Question: And how much did the Detroit Company add to that for customer distribution?"

[fol. 10448] This is a reference to the maximum day of January 7.

"Answer: The Detroit Company added approximately 28 million cubic feet."

Your figures were substantially less than that?

A. I did not say anything about what the Detroit company added. I said that they lacked about 15 million feet of taking the amount which Panhandle was under obligations to furnish to them, if they desired it.

Mr. Culton: He did not say what the send-out was, Mr. Chamberlain.

By Mr. Chamberlain:

Q. You gave no figures as to what they put into the lines?

A. I did not although I had them before me and have them before me now.

Q. All right. Then the fact is that the Detroit company put in some 28 million cubic feet on January 7, did it not?

A. It is really a trifle less than that. It is a trifle under 280,000 therms so, with gas of the heating value that was delivered on that day, the feet would be a little less than ten to one in proportion to that. It is a little less than 28 million but, for practical purposes, 28 million is close enough.

Q. Well, to be exact, the figure would be 27,926,000 therms?

A. I could work it out and see but I do not want to [fol. 10449] let it appear that that 28 million is the exact figure, is all. It is a little bit less than that.

Q. You referred to the 15 million as being an amount which assisted Panhandle in serving their other customers. Was not the 28 million the amount they were assisted by?

A. I think that could only be answered after a determination as to whether there is any obligation upon Panhandle Eastern to deliver in excess of 125,000,000 and I am not in a position to answer that matter. I am sure there is an obligation to deliver up to 125,000,000, but whether there is any obligation beyond that, I am not in a position to say.

Q. The question of contractual obligations has nothing to do with that. The question is as to whether or not the 28 million was not a contribution which enabled Panhandle Eastern to keep its other customers served to that extent.

Mr. Culton: We differ with counsel's construction of what the obligation was. Manifestly, there was no contribution at all as to any gas in excess of Panhandle Eastern's contribution under the contract. We agreed to contribute to them 125 million under the contract and, obviously, there is no obligation to furnish any more than 125 million.

Mr. Chamberlain: I am trying to say there is no claim of any obligation. I am trying to get out the fact that, instead of assisting Panhandle Eastern with 15 million feet, they assisted them with 28 million feet.

[fol. 10450] The Witness: Well, it is perfectly true that, as compared to delivering 138 million when they only delivered 110 million, that is 28 million feet less than Detroit would have used if they had taken natural gas for all of their requirements.

[fol. 10452] LEITH V. WATKINS, a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Recross Examination

By Mr. Chamberlain:

Q. Mr. Watkins, will you please refer to Exhibit No. 179. Where, in Exhibit No. 179, will you find all of the direct industrial or interruptible industrial sales of natural gas?

A. For the period from April 1, 1932, to December 31, 1941, sir?

Q. Yes, or any part of that period.

[fol. 10453] A. The direct industrial sales made by Panhandle Eastern Pipe Line Company and any of its subsidiary companies during that period will be found in Columns H, I and J.

Q. And what were the direct industrial sales in M.c.f.'s for the year 1941?

A. As shown by this exhibit, 5,358,169 M.c.f.

That appears in Column H on line 12.

* * * * * * * * * * *

Q. Now, what were the direct industrial sales in 1941 by Indiana Gas Distribution Corporation?

A. They, of course, are not shown in Exhibit No. 179.

Q. No?

A. I do not have the sales for Indiana Gas Distribution Corporation to Anchor Hocking for the year 1941 in any of the material I have with me, shown as a separate item.

Q. Do you have anything by which you can calculate what those sales were?

A. I can make a calculation, Mr. Chamberlain, which may give us the correct answer but I would not state that it was.

* * * * * * * * * * *

[fol. 10454] Q. If you will get your figure, it will certainly be subject to correction if you find it is incorrect.

A. I have made no computation as to volume. I made a computation as to revenue in dollars which I find is $13,007.72 which is likewise an amount shown in pencil

on your copy of Exhibit No. 251 which may have been the amount you copied down as such sales.

Q. That is right.

A. The witness' remembrance is that Witness Spacek gave the exact amount of such sales.

Q. Yes, I think he was the one.

A. At page No. 9971 of the transcript of the proceedings in this matter for the session of April 15, 1942, at lines 23 and 24, Witness Spacek, in response to a question put by Mr. Chamberlain stated the following and I quote:

"The M.c.f. were 1,222,643, the dollars were \$313,007.72."

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Q. That would be at a price of about 25.6 cents per M.c.f.?

* * * * * * * * * * *

A. I have not calculated it, sir.

Q. I will waive that. Now, the direct industrial sales [fol. 10455] shown on your Exhibit No. 179 plus the sales to Anchor-Hocking, as testified to by Mr. Spacek, total the amount which is found in line 4, Column B, of Exhibit No. 251, does it not?

A. I do not know, sir, I have made no computation with respect to this matter as to volume.

* * * * * * * * * * *

Q. Will you calculate it?

A. The difference between the volume of industrial sales, as shown by Exhibit No. 179 at Column H on line 13 and the volume of industrial sales shown opposite line 4 in Exhibit No. 251 is 1,122,643 M.c.f. which the witness believes is the volume stated by Witness Spacek at the point just referred to in the transcript of the preceding session in this matter as having been sales to Anchor-Hocking.

Q. Please refer to your Exhibit No. 55. Is it correct to say that this exhibit shows all of the direct and indirect interruptible industrial sales made by Panhandle Eastern during 1939, 1940, and the first half of 1941, where

the amounts of the accounts were $20,000 per year or over?

A. This Exhibit No. 55 shows the sales and revenue from sales by Panhandle Eastern Pipe Line Company and subsidiary companies for those years to all direct and indirect customers whose annual purchases were in excess [fol. 10456] of the figure you state.

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Q. Now, Mr. Watkins, you have not filed in this case an exhibit showing the actual sales for 1941 in lieu of Exhibit No. 55, have you?

A. There has been no exhibit other than Exhibit No. 55 showing the exact data which it included, introduced in these proceedings.

Q. Do you have with you the total amount of sales and [fol. 10457] revenue of interruptible gas sold directly and indirectly during 1941?

A. I have the data from which the total amount of industrial sales for that year may be had which, however, would not be comparable to the information shown by Exhibit No. 55.

Q. And in what way would it not be comparable?

A. Exhibit No. 55 is a record which shows, in numerous instances, a portrayal of sales in a specified amount per annum. The information the witness has with respect to the total industrial sales for the year 1941 would include all industrial sales.

[fol. 10458] Trial Examiner: Perhaps counsel can clarify this matter. Mr. Biddison's testimony was positive and direct on that point, as I recall it.

Mr. Culton: Well, there is this distinction. Counsel interrogating the witness is referring to all of the sales, industrial sales. That includes indirect sales as well as direct sales. In other words, it includes the gas which is subject to regulation and that which is not subject to regulation. Mr. Biddison was only testifying with respect to the interruptible gas or the industrial gas which is sold directly by the company.

As I understand it now, he is attempting to find out how much industrial gas is sold and how much of it, sold indirectly, is interruptible. Is that correct, Mr. Chamberlain?

[fol. 10459] Mr. Chamberlain: You stated it very fair. I am trying to find out here, of course, the amount of industrial sales, direct and indirect.

Mr. Culton: Interruptible and non-interruptible?

Mr. ~~Chamberlain: Interruptible and non-interruptible.~~ It has been testified to here a time or two that these sales were all interruptible, as I understand it. If there happens to be two or three small ones, I do not think it would make a great deal of difference but if the company has this information, I would be glad to have it.

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The Witness: (Interposing) I have to withdraw my answer because I misunderstood the question entirely. I ~~had no idea~~ Mr. Chamberlain's question was directed to indirect industrial sales.

Panhandle Eastern would only be able to determine the indirect industrial sales made during the year 1941 by inquiry of its customers. Gas sold by Panhandle Eastern for resale under its rate schedules or its contracts may be sold by the distributing organization to industries without any knowledge on the part of Panhandle Eastern whatever.

Take the case of the Michigan Consolidated Gas Com-[fol. 10460] pany. If Michigan Consolidated Gas Company wishes to buy gas—

Mr. Chamberlain: (Interposing) I am sorry to interrupt but that has nothing to do with the sales whatever. I am asking for the sales of Panhandle Eastern.

The Witness: I cannot give it to you.

Mr. Chamberlain: You cannot give it to me?

The Witness: Not the way you ask the question, sir.

Trial Examiner: Do the company's records contain the information he wants?

Mr. Chamberlain: The witness can give it. The witness loves to play on words but the witness is wrong here. I am not asking you for the sales that a customer has made that you have nothing to do with. You have your special indus-

than contracts with your distributing utilities and I take it that all you have got in Exhibit No. 55 is that type of sales, those in which you participate—

The Witness: (Interposing) Let's see if we can understand what we are trying to get, Mr. Chamberlain.

By Mr. Chamberlain:

Q. We have got it already. All I want is a continuation in Exhibit No. 55 showing the sales to those taking less than $20,000 per year.

A. If that is all you want, the information will have to be prepared.

Q. You said you had it here a short while ago.

[fol. 10461] A. No, sir; I stated later I misunderstood your question.

Mr. Culton: I think counsel used the word "industrial", where I think he meant "interruptible".

The Witness: He used the word "interruptible" and he has used the word "industrial" until he has me in a fog.

If you want information exactly parallel to that included in Exhibit No. 55 and you want it for the year 1941, the only way we can furnish it is to obtain it. The witness does not have that information with him.

I do have the total amount of industrial sales which Panhandle Eastern made during the year 1941. That, however, as I have stated before, is not parallel information to Exhibit No. 55.

By Mr. Chamberlain.

Q. All right. What were the sales of Panhandle Eastern then in the year 1941, industrial sales?

A. You could not use February 28, could you?

Q. No, sir, I want the year.

A. I am sorry, I do not have the financial statement for December 31, 1941, with me.

Q. Well, what was the paper you were about to read from there a few moments ago?

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[fol. 10462] A. I do not remember, Mr. Chamberlain, anything that I was about to refer to for the industrial sales

for 1941 of Panhandle Eastern alone because most of my information has been supplied on the basis of Panhandle Eastern and subsidiary companies.

Q. Well, is it your delight now to separate them?

A. You asked for them separately, sir.

Q. That is, you interpreted my question that way.

A. No, sir, you asked for that.

Q. I am asking for comparative information to that on Exhibit No. 55.

A. I do not have it.

Q. Well, do you have it by subsidiaries, then?

A. ~~I do not have it by subsidiaries.~~

Q. Do you have it for Panhandle?

A. No, sir.

Q. Do you recall a report having been made to your Board of Directors which gave that amount?

A. There no doubt were reports made to the Board of Directors which had such an amount but I do not know where your question is apropos here because very obvious-[fol. 10463] ly, the witness would not have with him all of the matters that had been referred to the Board.

Q. I assumed perhaps you were present. Were those sales in excess of the estimate which you made in Exhibit No. 55 for the year 1941?

A. I do not know.

Q. Can you supplement Exhibit No. 55 by showing the actual sales to each of the customers indicated for 1941?

A. Each of the customers indicated, sir, or do you want Exhibit No. 55 supplemented for the year 1941 comparable to the information shown for the prior years even though there be other customers than those shown on Exhibit No. 55?

Q. Well, I am trying to find my way as to how to ask you for what I want.

Q. I was starting now with the customers indicated.

A. May I try to help you, sir?

Q. Yes, I would be most grateful.

A. Let the witness then suggest that there be reserved an exhibit number which may be used later for the introduction in this record of data for the year 1941 exactly similar to that furnished through Exhibit No. 55 with re-

spect to the years 1939 and 1940 and that, I believe, is exactly what you are trying to ascertain.

[fol. 10464] Q. That certainly is the first step.

A. Shall we have such a number then?

Q. Yes. If you will prepare that, that furnishes us with data which is contained in Exhibit No. 55 brought down to date.

Mr. Culton: What exhibit number will that be, Mr. Examiner, and we will show the exhibit number on it.

Mr. Chamberlain: I think we can include in this exhibit several other things which will save numbering a lot of exhibit.

Mr. Littman: Why not mark it Exhibit No. 55-A? It is supplemental thereto, isn't it?

Mr. Chamberlain: Yes.

Mr. Littman: I mean, that is similar to Exhibit No. 55 and, because of its supplemental nature, it could be marked Exhibit No. 55-A.

Trial Examiner: I think the suggestion is very proper and it will be agreeable to counsel, I assume, that that data, to be supplemental to Exhibit No. 55 and to be marked Exhibit No. 55-A, shall be sent to the Trial Examiner within one week for inclusion in the record with copies to every counsel?

The Witness: Mr. Examiner, I am afraid we could not do it within a week. We shall be very careful to do it as quickly as possible, sir. This exhibit requires rather minute examination of our records and may require our ascertaining some of the information from some of our customers.

[fol. 10465] Trial Examiner: That raises the question of just how important this is, Mr. Chamberlain? We have got an interminable record in this case and the Trial Examiner has no disposition to enlarge it one page.

Mr. Chamberlain: This is something that the Commission will have to have before it determines this rate case beyond any question.

Trial Examiner: What issue is the exhibit addressed to?

Mr. Chamberlain: Exactly this: Exhibit 58 or Exhibit 479 shows only direct industrial sales. The company, as I understand it, has a system of putting out special industrial sales contracts with its gas distributors. In these contracts, gas is sold usually on an interruptible basis for a given price of which the distributing utility gets a certain percentage or an agreed amount.

These sales are all made in a competitive way with other fuels. They are made now at a time when the price of competitive fuels has risen substantially. They are in a class by themselves. There would be no reduction of the price, in so far as these industrial sales contracts are concerned. As a matter of fact, there is a considerable question as to whether or not the public would not have a right to ask that they be gone over and the price raised with respect to them.

In any event, whether that be correct, or not, any reduction in the rates of this company would apply and should [fol.10466] apply to those sales other than these special industrial contracts.

Now, the purpose of this is to segregate these contracts, get them by themselves. To make a concrete illustration, the exhibits in this case show that, in 1941, this company had revenues of, let us say, approximately—I do not have the information before me—of $14,800,000 and let us say that the gasoline extraction was $800,000, that may be a little large, but we have $14,000,000 to start with. These industrial contracts represent about $4,000,000 and this information was given in testimony by Mr. Neuner very recently.

Exhibit No. 55 shows about $3,600,000 without those contracts which produce $20,000 a year or under. The chances are that the estimates here were probably exceeded a little bit but, in any event, these contracts will be some $4,000,000.

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Mr. Chamberlain: In applying a reduction to the rates of Panhandle Eastern, the $4,000,000 would first be de-

ducted and the reduction applied to the remaining $10,000,000 for the simple reason that these contracts, taken on a competitive basis and an offset fuel basis, would not be in line for reduction.

Mr. Clifton: We do not concur in that statement of the law, Mr. Examiner.

Trial Examiner: Let me ask you this, Mr. Chamberlain.

[fol. 10467] Knowing that the proceeding is going to the Commission on a motion for an interim order, is not the question that you are now presenting a part of the question of how the reduction shall be made, if any is made?

Mr. Chamberlain: That is correct.

Trial Examiner: Following the precedents which the Commission has established in the same kind of proceedings, would not that properly be deferred until the final disposition of the case after the Commission has first determined whether or not the earnings of the defendant company are larger than the law contemplates?

Mr. Chamberlain: You could defer it any length of time you wanted to but, if they have it in the record, they do not need to defer it.

Furthermore, it is necessary here before I conclude my cross-examining of Mr. Biddison of the question of his allocations in Exhibit No. 251. He has stated here that the maximum day is dependent upon the sales for resale and that it is so determined. I must have the amount of these industrial sales which are made under the sales for resale so that I may add them to the other industrial sales to determine what capacity is necessary for these interruptible industrial contracts. His position is that there has been no construction here for the purpose of providing capacity for peak days.

[fol. 10468] Now, he interprets the matter to cover only the direct sales and states that the indirect sales are something different and apart. They are exactly the same thing only under color of a different form of contract. The price that they get for them is substantially the same and the amount of those sales is absolutely necessary to determine these capacities. It is going to be necessary, before I get

through with Mr. Biddison, that I have this information. I do not have to have it to the last thousand M.c.f. at all, but I must have it. There is no question that one third of the total volume of this company is sold for industrial purposes. There is equally no question that they are getting about $4,000,000 for it.

Now, if we want to spar around here for hours as to whether or not it is $3,956,000 or $4,120,000, that is all right, but there is no necessity for it. This is a simple matter and it should have been done before concluding this case. It should have been given here—

Trial Examiner: (Interposing) The retort to that is, Mr. Chamberlain, you should have made your request much earlier.

Mr. Chamberlain: I have requested it a dozen times here.

Mr. Culton: I would like to have the page number shown where you made that request.

Trial Examiner: We will leave that for a moment. Have you other questions of Mr. Watkins, other than relating [fol. 10469] to this matter? If it is possible to excuse him today, I should like to do so. We can defer further discussion of this information that has just been requested until morning, perhaps.

The Trial Examiner's hesitancy is, of course, due to the fact we are trying to fix a terminal for this proceeding and when that is done, we will then set a time for briefs and we do not want to enlarge the period that we have more or less tacitly and otherwise assumed will constitute a limit for the completion and submission of the case.

Mr. Chamberlain: I had an agreement with Mr. Culton, not over twenty minutes ago, that this would be furnished. Now, the witness is on the stand—

Mr. Culton: (Interposing) That is not so. The statement is not so.

Trial Examiner: Let's get back to the merits of this. Have you other questions of Mr. Watkins?

Mr. Chamberlain: They are directed along this same line. If there is any question about this, we should take the time to consider it but we are going to have to have this information. It is directly in line with what the company itself has put in. Why, at this time, can they say it is not material when we are merely trying to bring down to date the very evidence they put in themselves? That is exactly what we are trying to do.

[fol. 10470] Trial Examiner: You say you have asked for this information before?

Mr. Chamberlain: I have asked for it many times.

Trial Examiner: I have no recollection of it and I think you should cite the page.

Mr. Chamberlain: I have not kept track of the page numbers.

Mr. Culton: When did you ask us for it?

Mr. Chamberlain: I asked you for it at various times.

Mr. Culton: You asked for it at recess.

Trial Examiner: Mr. Watkins has been on the stand many times and the Trial Examiner feels, if the matter is so important, it should have been brought before us much sooner because the witnesses have shown no reluctance to bring the material in that has been asked for.

Mr. Lee: I think Mr. Chamberlain is absolutely right. It is going to make a good deal of difference where this cut goes, if it is made, whether it goes to the householder or whether it goes to the industrialists. Of course, both of them will get some cut, if a cut is made, but it will make a good deal of difference in the proportion of the cut which goes to each class of customer and, if you will pardon me, I think it is really of major importance, Your Honor.

Trial Examiner: You will recall, however, Mr. Lee, that in the Natural Gas Pipeline Company case, the Commission [fol. 10471] first made a broad order and requested the company to file new schedules. I assume that before the matter is disposed of by the Commission as to the specific rates which shall be put into effect there may be much more opportunity for consideration of such matters as are

now presented and, incidentally, it might be remarked that the effect of War Production Board Order No. L-31 may present an entirely different problem before that final fixing of rates.

Mr. Lee: There is a great deal of truth in that, Your Honor, but, on the other hand, shouldn't this information be in the record that Mr. Chamberlain wants to get in?

Mr. Chamberlain: Mr. Examiner, you mentioned the Natural Gas Pipeline Company but you do not mention the Canadian River which is exactly in point with this one.

Trial Examiner: No, Mr. Chamberlain, the Canadian River case did not go in on an interim order.

Mr. Chamberlain: The Canadian case requires a reduction upon the first, the producing company. That would be passed on to the distributing company.

Trial Examiner: Yes, but the distinction I am making is this: The Canadian case was submitted and concluded and the Commission made a final order.

In the Natural Gas case, the motion for an interim order was presented just as we have been warned will happen here and the Commission has disposed of that case, in part, [fol. 10472] by its interim order.

Mr. Chamberlain: It had to take the evidence before it completed the Canadian case. In this case, you have first got to determine what the excessive return of Panhandle Eastern is. That has to be passed on to Michigan Gas Transmission to the extent that it buys gas. It performs the double function, one of transportation of gas for which it receives compensation and the other is the purchase of gas.

Until we get this information, we will be very poorly equipped to make figures for briefs. Furthermore, I feel it will be necessary, in Mr. Biddison's testimony, to have these figures, to have these quantities. You cannot examine him without them. You may say you can get along without the dollars, as far as Mr. Biddison is concerned, but you cannot get along without the quantities there.

* * * * * * * * * * * *

[fol. 10477] Mr. Montgomery: Mr. Examiner, the Intervener wishes to offer in evidence an exhibit which, we understand, is without objection from counsel and which consists of a letter from Mr. Morton, a witness in this case, in reply to a request from Mr. Chamberlain, showing the difference in the demand charges for the calendar year 1941, the calendar year 1942-1943 and showing the increase in the cost of gas in 1942 over the cost of the same amount of gas in 1941 as being $1,005,316.

Trial Examiner: This will be marked for identification as Exhibit No. 255.

(The document referred to was marked Exhibit No. 255 for identification.)

Mr. Culton: As I understand it, that exhibit is a three page document?

Mr. Montgomery: Yes.

Mr. Culton: May it be understood that the third page of this document is a document which had been prepared and exhibited by counsel to Mr. Morton when he was on the stand?

Mr. Montgomery: That is right.

Trial Examiner: Have you copies of this proposed exhibit?

Mr. Montgomery: Yes.

Mr. Examiner, we feel that this exhibit should be of [fol. 10478] great importance, both to the Examiner and the Commission for this reason: If it appears that on the Defendant's own testimony a reduction in rates of as high as 40 per cent or more is possible under their own showing, the Commission should take into further consideration the fact that this year the net income of Panhandle Eastern will be increased $1,000,000 over last year for the same quantity of gas and that that increase is in effect this next month. Michigan Consolidated Gas Company starts paying this higher rate, which will yield this million dollars extra, on the first of this next month.

(Exhibit No. 255 was received in evidence.)

Mr. Chamberlain: I am now presenting a copy of the contract of September 17, 1930, between Columbia Oil & Gasoline Corporation, the National City Company and Missouri-Kansas Pipe Line Company, which has been referred to in these proceedings on numerous occasions and concerning which I made an offer of the copy printed, I believe, in Volume 62 of the Federal Trade Commission Reports. It was suggested at that time that I prepare [fol. 10479] copies which could be distributed to counsel and I have included in these copies all of the supplements or amendments to that contract as they appear in that volume.

Trial Examiner: This will be marked for identification as Exhibit No. 256.

(The document referred to was marked for identification as Exhibit No. 256.)

Trial Examiner: You are offering that, Mr. Chamberlain?

Mr. Chamberlain: Yes, the Intervener offers in evidence Exhibit No. 256.

Trial Examiner: Is there any objection?

* * * * * * * *

(Exhibit No. 256 was received in evidence.)

[fol. 10480] Leith V. Watkins, a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Recross-Examination (Continued)

By Mr. Chamberlain:

Q. I have before me the transcript of yesterday's hearing and I am anxious to avoid the use of any more time than is absolutely necessary but I would like to ask the witness one or two questions with respect to the information which I wished, particularly with respect to Exhibit No. 55.

Would you refer to that exhibit, Mr. Watkins? Are the indirect sales listed in Exhibit No. 55 those arising out of what are known as special industrial contracts?

A. I think, in most instances, they are, Mr. Chamberlain, but I cannot necessarily answer your question without some qualification.

Q. Do you have any of those contracts, in which the settlement period is longer than one month?

A. I would not know that, sir, off the top of my head.

Q. Well, you mean you may have contracts in which the settlements are for the use of gas for a period longer than one month?

A. No, sir, I do not. I simply mean I cannot, by any stretch of the imagination, remember everything that is [fol. 10481] in every contract that the company has.

Q. Do you remember any contract of any kind of your company during any year that you have been an officer of it which extended credit to a company for more than one month's gas at one time?

A. My rememberance is that the settlement provision in most of the contracts is within a month's period. There are also certain provisions in those contracts, if I recall them correctly, that a purchaser of gas may not necessarily discharge that obligation within a month's period. If there be some differences as to the amount of the charge, there is a provision by which that may be arbitrated and, in certain instances, interest payments are required and so forth.

Q. There might be some exception whereby a company might not settle promptly at the first of the month, is that correct?

A. That is correct.

Q. Now, then, looking at the companies listed in Exhibit No. 55, do you recall any of those which are back on their payments two or three months?

A. Mr. Chamberlain, the witness would not have any information whatever with respect to the payments made to him by the customers shown on Exhibit No. 55 because they are not all direct customers of Panhandle Eastern or its subsidiary companies. I have no idea when the Indiana [fol. 10482] diana Steel & Wire Company, for instance, purchases its gas from the organization from which it

purchases and that answer would apply to many of the customers listed on this exhibit on lines 9 to 39, inclusive.

Q. But they are all made under contracts of which your company is a necessary party, are they not?

A. They are not.

Q. Is there contract there that your company does not participate in to the extent of the major part of the revenues derived from them?

* * * * * * * * *

A. Panhandle Eastern does not have contracts directly with the indirect industrial customers. Let's get that straight.

Q. I understand that perfectly.

A. You do not ask your question as though you did, sir.

Q. Yes.

A. Now, Panhandle Eastern has certain contracts under which certain industrial customers may buy gas. The underlying contracts in such instances are not contracts between Panhandle Eastern and the user. Those are contracts between the user and the distributing organization.

[fol. 10483] Trial Examiner: Mr. Watkins, may I interrupt at that point?

The Witness: Certainly.

Trial Examiner: And refer you all to page 10465 which is a statement made by Mr. Chamberlain at the hearing yesterday. He refers to these special industrial sales contracts with the gas distributors to which you have just made reference. He then makes this statement:

"In these contracts, gas is sold usually on an interruptible basis for a given price of which the distributing utility gets a certain percentage or an agreed amount."

Is that statement correct?

The Witness: Generally it is, Mr. Examiner, but there are not a vast number of such contracts.

Trial Examiner: Is that form of contract included in the rate schedules which are on file with the Federal Power Commissioner?

The Witness: Yes, sir, it is. There is, if I recall correctly, one major contract under which such conditions exist. That is a contract dated as of August 1, 1936, between Panhandle Eastern Pipe Line Company and Michigan Gas Transmission Corporation. It is not a general or customary practice.

Trial Examiner: I assume counsel would agree that such sales would be regulated sales?

Mr. Culton: That is, indirect sales. Now, there is a different situation now as to a good many of these [fol. 10484] contracts from the situation which existed a year ago, as I understand it. Some of the sales that were formerly indirect sales may now be direct sales but we do fully agree that all indirect sales, whether they are interruptible or firm, if they are sales for resale, are subject to regulation by the Commission.

Mr. Littman: Hasn't Mr. Biddison given us and put into the record his list of all of the direct industrial customers?

Mr. Culton: That is right and we concede that all those others, which are reflected in last year's business, are sales for resale and subject to the Commission's regulation.

Trial Examiner: And have been made under prevailing rate schedules on file with the Commission?

Mr. Culton: Yes, sir.

* * * * * * * * *

By Mr. Chamberlain:

Q. Now, do you know of any of the companies listed in Exhibit No. 55 which have failed to settle for their gas up to the end of 1941?

A. I have made no examination to determine that fact, sir. Consequently, I do not know.

Q. Have any been reported to you as having been in default?

A. They would not necessarily be reported to me.

[fol. 10485] Q. I am asking you if any of them have been reported to you.

A. No, they have not, but they would not necessarily be reported to me.

Q. You have closed the books of Panhandle Eastern for the year 1941, have you not?

A. Yes, the books have been closed.

Q. And you have prepared and distributed your Annual Report, have you not?

A. That has been done.

Q. And you have in your office determined the amount of industrial sales, both direct and indirect, made by Panhandle Eastern during the year 1941, have you not?

A. No, sir.

Q. That has not been done?

A. Not separated.

Q. What do you mean by separated?

A. We make no separation in our office, Mr. Chamberlain, of the direct and indirect industrial sales until and when the occasion arises.

Q. You did not separate them in Exhibit No. 55, did you?

A. We did not. We do not necessarily keep a running record of the annual indirect industrial sales because that information has to be obtained from other sources.

Q. Now, that opens two questions but first, I was unaware that I asked you to separate your [fol. 10486] direct from your indirect industrial sales. I asked you, if I spoke what I intended to, whether you had the amount of your industrial sales for 1941?

A. You did not say that, sir.

Q. I am sorry. If I did not, I intended to.

A. That, sir, is included in Exhibit No. 251.

Q. Exhibit No. 251?

A. Yes, sir.

Q. And what is the figure then?

A. As shown by Column B, line 14 of Exhibit No. 251 by Witness Spacek, the total industrial sales of Panhandle Eastern Pipe Line Company and subsidiary companies expressed in revenue for the year 1941 amounted to $1,-223,730.92.

Q. Now, you told me a moment ago that you did not have that separated. What does that figure you have given represent?

A. All direct industrial sales made by Panhandle Eastern.

Q. Then you did have it separated, didn't you?

A. We do not, sir.

Q. That represents, of course, your direct sales. I am asking you for your total industrial sales which would, of course, necessarily include that as you did include them in Exhibit No. 55.

A. Mr. Chamberlain, I do not believe we understand [fol. 10487] where we are trying to go. If you will observe line 17 of Exhibit No. 251, you will find there the total amount of gas that Panhandle Eastern sold during the year 1941 to gas utilities.

Q. That is right.

A. Included in those sales is certain revenue received by Panhandle Eastern Pipe Line Company from the utilities covering indirect industrial sales.

Now, we have no information assembled for the year 1941 with respect to the amount of those industrial sales by customer or otherwise.

Q. You are now referring to the indirect industrial sales made by the distributing utilities in which they sell the gas which they have purchased from you directly to their customers, are you not?

A. That is right.

* * * * * * *

[fol. 10489] Q. Now, Mr. Watkins, what I want is the amount of the industrial sales by Panhandle Eastern for 1941, including your direct and the indirect sales which, as Mr. Culton describes them, may be classified as sales by Panhandle Eastern or sales to the distributing utilities for which Panhandle Eastern receives a percentage of the sale price.

A. The witness has been trying, Mr. Chamberlain, to tell you for several hours that he does not know that amount. Our classification of accounts is such that we characterize, as industrial sales, the amounts shown on line 14 of Exhibit No. 251 which is the direct industrial sales that Panhandle Eastern makes. All of the sales that Panhandle Eastern and its subsidiary companies make to other organizations for resale are included in the amount shown opposite line 17 on this same exhibit.

Mr. Wheat: You are referring to Exhibit No. 251, aren't you?

The Witness: That is correct, sir.

Now, any segregation of the $15,725,780.73 shown in Column B opposite line 47 representing sales to gas utilities which includes the sales to them for resale for industrial purposes, will have to be developed.

[fol. 10490] By Mr. Chamberlain:

Q. Now, did you develop it for the years 1939 and 1940 with respect to these accounts of over $20,000 per year?

A. That was done, sir, and there is an exhibit in these proceedings that shows that that fact exists.

Q. All right. Now, to bring that to date, it would require you to set up in an exhibit the amount which each one of those companies purchased during the year 1941, would it not?

A. That is correct.

Q. And on your books you have every one of those figures, do you not?

A. We do not.

Q. You do not, sir?

A. We do not, sir.

Q. What account do you keep of your special industrial contracts?

A. Mr. Chamberlain, for the distributing organization to whom we sell gas for resale, we carry an account with that organization.

Q. Right.

A. We render a statement to that organization each month.

Q. Right.

A. Showing the amount of gas sold for whatever purpose it was sold. We have no record whatever, as far as [fol. 10491] this witness knows at the moment for the year 1941 that gives us the total amount of gas sold, for instance, under a special industrial contract to the Guide Lamp contract at Anderson, Indiana, which happens to be one of the organizations shown on Exhibit No. 55.

To get that information for the year 1941, we would have to compile it from twelve monthly statements. If we did not have it on those twelve monthly statements, we would then have to, in turn, go to the distributing or-

ganization to whom the gas was sold for resale and get the information.

Q. Will you state into the record how it would be possible for you to determine the amount which you would be entitled to receive on the contract with the Guide Lamp Company unless you had the figures of the volume and the sales price for each and every month?

A. I believe that has been done. It seems to me that I just finished giving you a recitation that would cover that.

Q. What you are trying to say is that you do not carry a single account in which you post the total year's results of those separate contracts and that you would have to take off twelve figures instead of one.

A. Nor do we carry a single account in which we post the monthly figure but we do have information in the office which shows the amount.

* * * * * * * * *

[fol. 40492] A. The exhibit shows that, sir. It is not necessary to ask the witness that question.

Q. What you would be required to do would be to go to your files and take off the sales to each one of these companies for six months. Is that right?

A. That is right.

Q. All right. Then you can do that?

A. Mr. Chamberlain, we told you yesterday afternoon quite some hours ago that this could be done and at that juncture, we were about to reserve Exhibit No. 55-A to cover the development of this information for the year 1941. The record should not show any inclination on the part of the company not to supply the data.

Q. Really, I don't think it does. It shows a great disinclination to cooperate in furnishing exactly what we wish but here is the disturbing thing.

In response to the Examiner, you stated you were afraid you could not do it in a week.

A. I still say that.

Q. But all that would be required would be to take six figures off the monthly statement for each one of those

companies, add them together and add them to the six months that is already stated?

A. Of course, Mr. Chamberlain, the only thing we have [fol. 10493] to do is to answer questions with respect to this proceeding.

This witness is already, and the company too, accused of the lack of diligence with respect to our original cost studies. Day after tomorrow, I am meeting a portion of our staff in Chicago to go over our preliminary draft of the answer to the Commission's Order No. 73 which is the original cost filing. We can get this information and we will be very glad to get it but we cannot dish it up here like a short order for a hamburger.

Q. I have the greatest respect for your energy and your desire to do things but you cannot be a one man army and this requires an ordinary bookkeeper to compile that exhibit and no one else. It does not require your time or require—

Mr. Culton: (Interposing) I want to ask counsel when, before yesterday, he has ever requested that data to be furnished. He stated on the record yesterday he had previously called for it and we asked for the page of the record but he did not give it. I again ask him when he ever asked for that information before yesterday.

Mr. Chamberlain: I told you I do not think I ever asked for it on the record.

Mr. Culton: When did you ask for it off the record?

Mr. Chamberlain: What difference does it make? We are trying to get a piece of factual information which you agreed to furnish to me.

[fol. 10494] Mr. Culton: You did not tell me then what you want now.

Mr. Chamberlain: Yes, I did. There is no use quarreling about it. This is ordinary factual information and can be compiled by a bookkeeper in an hour.

What I wish here is exactly what Mr. Watkins has stated he would furnish but the disagreements seem to keep coming. A week won't make a great deal of difference if

I get the approximate amount. I am sure that this has been already determined for the benefit of your operating committees. They could not get along without it.

The Witness: You had better let us say what has been determined and what has not and you had better let the company state how this data is to be prepared. It does not presume to tell you how to handle your law affairs.

By Mr. Chamberlain:

Q. The president of the company had practically determined what it was when he testified here some months ago and he must have had some information on which to base that testimony because he is a fairly accurate man. His testimony was it would be around $4,000,000 for industrial gas.

Now, do you recall that as being substantially the amount of industrial gas for 1941?

A. I have no opinion with respect to that.

* * * * * * * *

[fol. 10495] Q. Were you in the room when I read Mr. Neuner's testimony yesterday?

A. I was, but I paid no particular attention to it.

Q. All right. Mr. Neuner was asked in the proceeding known as Docket G-210 certain questions which appear on pages 505 and 506 of the transcript as follows:

"Question: Now, you have a total sales of about $14,000,000 a year?

"Answer: In dollars, our gross revenue, from all sources is somewhat in excess of $14,000,000, yes.

"Question: At the present time?

"Answer: At the present time."

This testimony was given October 21, 1941.

"Question: And your industrial sales amount to about $5,000,000?

"Answer: I do not have the exact figure in mind but I would judge from my knowledge of what our average ... on the basis of selling about 20 billion feet

[fol. 10496] of industrial gas, I would say our industrial sales might account for as much as $4,000,000 a year, maybe slightly under that or it might be slightly over."

"Question: Then that would leave about $10,000,000 of sales from the gas utilities, such as Michigan Consolidated?"

"Now, is it your judgment, as the chief financial and accounting officer or chief accounting officer, that the industrial sales were about 20 billion feet in 1941 and that the income or revenue from them was about $4,000,000?

A. I have no judgment with respect to that.

* * * * * * * *

Q. On page 506, it is stated:

"Our sales to special industrial interruptible and off-peak dump industrial customers for the year will be [fol. 10497] slightly under $4,000,000."

* * * * * * * *

Q. (Interposing) Will you verify that and see if your industrial sales as described by Mr. Neuner were substantially as he indicated?

A. Does Mr. Neuner define his use of the words "industrial sales"?

Q. Shall I read it again?

A. You may if you wish. If that gives the description, I would like it, because the only industrial sales this witness knows of with respect to Panhandle Eastern are those shown in Exhibit No. 251 which are direct industrial sales and indirect industrial sales, for the year 1941, are included, as the witness has said several times, in the amount of gas sold for resale and is shown opposite line 17 in Column B on Exhibit No. 251.

[fol. 10498] Q. I am not concerned with what you have omitted to show. What I am getting at is a development of your Exhibit No. 55, as you know.

* * * * * * * *

Trial Examiner: Just a moment, gentlemen. If the data you are discussing is coming into this record, I suggest that it would be preferable to have it come in in an orderly way.

Mr. Chamberlain: I had hoped that it would.

Trial Examiner: The issue, I assume, was raised by your request for an enlargement of the contents of Exhibit No. 55 which was discussed yesterday afternoon when you stated that would give you the exact information you desire if you could have it in time. The Trial Examiner then expressed a reluctance to extend the termination of this proceeding to permit that because the request has come in so late. I do not think that it is serving any useful purpose to discuss the record and the testimony in Docket G-210 which is not inclusive of exact data.

Mr. Chamberlain: I know of no reason in the world why we cannot have Exhibit No. 55 extended to the end of 1941 as all of the other exhibits have been extended. I know of no reason why we should not have the facts as to [fol. 10499] those customers coming plainly within the import of Exhibit No. 55 which had sales of less than $20,000 per year. Those are merely factual matters which appear on the books and records of this corporation.

Trial Examiner: You can raise the issue on the record if you want to and you will get a ruling.

Mr. Chamberlain: Further than that, the element of making it part of this record, even if it takes a week, is not going to be at all material because it is going to take time to file these motions and to file the briefs that must accompany them and I shall ask that the witness prepare and file an extension of Exhibit No. 55 which will show the results for the full year 1941 and that this exhibit shall be so extended as to include the sales coming within the purport and intent of Exhibit No. 55 from all of those customers whose industrial sales are under the $20,000 per year limit.

Trial Examiner: May I ask whether that $20,000 factor entered into the preparation of Exhibit No. 55, Mr. Watkins?

The Witness: Yes, sir, it did.

Trial Examiner: May I also ask how much time it would take to add these six months to the scope of your Exhibit No. 55?

The Witness: As an accommodation to the Examiner, we will bend every possible effort to have the extension ready sometime between the 26th and the 30th.

Trial Examiner: Today being the 21st.

[fol. 10500] Mr. Wheat: May I ask, Mr. Examiner, whether the [witin] that statement, refers to the extension of Exhibit No. 55 alone and as such?

The Witness: That is correct.

Mr. Wheat: Yes.

The Witness: And that, of course, will interfere with our original cost work.

Mr. Wheat: It will include the companies which purchased industrial gas directly and indirectly and whose annual bill in 1941 was over $20,000?

The Witness: It will include the exact same information for the year 1941 as now shown in Exhibit No. 55 for the years 1939 and 1940 in the same manner.

Trial Examiner: Now, Mr. Chamberlain, will you please state just what importance you attach to this additional data in view of the expectation of us all that a petition for an order making an immediate reduction without final disposition of the case be presented to the Commission within a few days?

Mr. Chamberlain: I have already stated on the record the purpose of this evidence, the necessity of it. I have been asked here why I did not ask for it before.

When Mr. Watkins was on the stand before, the Examiner stated that we were not to cross-examine these witnesses except on the matter of clarity of the exhibits until they were recalled later and, to the best of my knowledge, [fol. 10501] he has not been recalled for cross-examination but he is here right at this time.

Trial Examiner: I am sorry this record fails to show the attendance of individual counsel in this proceeding but the Examiner will state for the record that Mr. Chamberlain has been absent many days during the proceeding but the Examiner has no knowledge whether Mr. Chamberlain was present during the cross-examination of Mr. Watkins which consumed several days.

Mr. Chamberlain: Mr. Chamberlain has not been absent any considerable length of time from this hearing and he has had the record when he has not been here.

Trial Examiner: Now, will you please deal with the merits of the question the Trial Examiner asked?

Mr. Chamberlain: Yes. We are faced here with an allocation that is placed in evidence by the Respondent. That has been motivated, as the record will indicate, by the decision of the Commission in the Canadian River or Colorado case. We are faced with the necessity—

Trial Examiner: (Interposing) You are referring now to Exhibit No. 251, are you?

Mr. Chamberlain: Yes, Exhibit No. 251. That is what has originated this cross-examination and the cross-examination of Mr. Biddison and the objection was made that I was asking the wrong witness.

[fol. 10502] I put this man on to get the evidence that they say he cannot furnish. Now, we are faced with the statement and I am unable to know how the Examiner can know that the Commission will make an order in this case as they did in any one case or in another case. That, to me, is not clear. In the one case—

Trial Examiner: (Interposing) Pardon, has the Trial Examiner made any such statement?

Mr. Chamberlain: I thought he did yesterday, yes. Your statement was, as I recall it, that you felt that the Commission would make an order such as was made in the Natural Gas Pipeline Company case which was and I am assuming, of course, in the event that a reduction should be ordered, that it would be of some specific amount on which later hearings could be had.

Trial Examiner: No, pardon, but the statement on the record of yesterday was that we have been apprized a motion will be submitted to the Commission for an interim order granting an immediate reduction and the Trial Examiner called attention to the nature of the order which the Commission had adopted in the Natural Gas Pipeline Company case.

That is immaterial, however. I am interested now in the merits of this pending question.

Mr. Chamberlain: Yes. I make no point of that, of course, but we must meet this thing as two companies. The [fol. 10503] evidence has been presented here now with later exhibits which would tend to show a consolidated statement of income of companies which are not consolidated and upon which they are asking, in these exhibits, for an allowance for taxes which are greater by reason of the changed ownership of the companies. These are being consolidated, as I say. Now, to determine and to allocate the revenues in this case, we must first have an allocation of Panhandle Eastern's business. We must then apply to that, to the business of Michigan Gas Transmission, such a reduction as would be necessary under the Panhandle Eastern setup. As I said yesterday, Michigan Gas Transmission has two functions, one is that of transporting gas for which it has a contract price. That is under the jurisdiction of the Commission. It sells gas. That is likewise under the jurisdiction but its costs are going to depend upon the costs and the proper return of Panhandle Eastern. Therefore, to follow this thing through as we have to do and as it was done in the Canadian River case, we must have first an analysis of Panhandle Eastern and, I think, we have a right to, if they come in with allocations of their own, we are entitled to cross-examine on those allocations and we are entitled to know the facts that these are based upon. We must have them and that is what I am after here.

As far as the length of time is concerned, there seems to be no dispute about this thing except a big smoke screen [fol. 10504] is being raised right here at a time when we want to get it. The witness has just said it would take five days and, in Exhibit No. 55, there are 59 names and it will require an accountant to set down—

Trial Examiner: (Interposing) I do not think that is material, Mr. Chamberlain. We have the statement of the witness as to the time. Let's do not take the time on this record today with unnecessary discussion or argument.

Let's get to the merits of what we have to deal with.

Have other counsel remarks to make with reference to this desired information?

Mr. Montgomery: Just a moment, Mr. Examiner.

Trial Examiner: We will ask you, Mr. Watkins, to supply this data at your convenience within the dates indicated, sending through your attorneys copies to counsel, which exhibit will complete the data shown in Exhibit No. 55 to the end of the calendar year 1941. That is my understanding of what is requested.

Is that correct, Mr. Chamberlain?

Mr. Chamberlain: You mean to confine it only to those —

Trial Examiner: (Interposing) To extend the data included in Exhibit No. 55 to cover the full calendar year 1941.

Mr. Chamberlain: Plus the sales to the same type of customers who take less than $20,000 a year, the purpose being, of course, to get all of the industrial sales.

[fol. 10505] The Witness: I cannot do that in a week, sir.

Mr. Culton: That is a different matter entirely. That specific question was asked a while ago.

Trial Examiner: We will ask the witness to prepare the data to complete the calendar year 1941 on the same basis as the data which has been prepared in Exhibit No. 55 and on no other basis and to send that in, as indicated, within the time which the witness has stated would not be greatly inconvenient.

This information, it may be remarked, will ultimately be of interest and the work may be done now just as well as later but we will not retard any other matters connected

with this proceeding on account of the supplemental information.

The Witness: Will the supplemental information, Mr. Examiner, be numbered Exhibit No. 55-A?

Trial Examiner: It will and will be merely, as the Trial Examiner has endeavored to indicate, an extension of the data included in your Exhibit No. 55 to include the full calendar year 1941.

The Witness: Yes, sir.

Mr. Chamberlain: I do not know that it is necessary but may Intervener have an exception to the ruling?

Trial Examiner: Certainly, and the Trial Examiner will remark in that connection that had this request been made when Mr. Watkins was previously on the stand and under- [fol. 10506] going a general cross-examination, the request would have been honored in full.

* * * * * * * *

[fol. 10507] By Mr. Chamberlain:

Q. Mr. Watkins, have you put in evidence in this case any evidence of original cost of the Panhandle Eastern properties as defined by the present Classification of Accounts for natural gas companies by the Federal Power Commission?

A. I do not believe we have unless the fact that counsel for Panhandle Eastern stated in the record that Panhandle Eastern and its subsidiary companies would not contend for an original cost greater than the cost shown per its books could be considered as such evidence.

Q. Now, has the Panhandle Eastern accounted for the property as constructed since 1930 on the basis of cost?

A. As far as this witness knows, it has.

* * * * * * * *

[fol. 10508] Q. Well, you knew those examinations were being carried on by accountants of the Federal Trade Commission in the office of Panhandle Eastern, did you not?

A. Yes, sir, we knew they were being carried on but we were not making the studies for them, sir.

Q. Now, you studied with them, did you not?

A. No, not at all.

Q. You did not? A. No, sir.

Q. Who were the men who examined Panhandle Eastern accounts for the Federal Trade Commission?

[fol. 10509] A. I believe the examiners' names were Steele, Sternberg, perhaps a lad named Dalrymple, and some assistants whose names the witness does not recall.

* * * * * * * *

Q. Do you have Exhibit No. 107 before you?

A. Exhibit No. 107, sir?

* * * * * * * *

[fol. 10510] Mr. Chamberlain: This is a listing application of the $12,000,000 Panhandle Eastern Pipe Line Company 3 percent bonds.

The Witness: On the New York Stock Exchange?

* * * * * * * *

Q. Now, on page 72 of that exhibit, which is, in effect, page 72 of the Prospectus, there is this statement:

"A (4). Property, plant and equipment is stated at cost except for $2,417,948.52 thereof assigned by the Board of Directors to assets acquired as of August 31, 1930, as a capital contribution and intangibles are stated at cost except for $2,398,402.19 thereof assigned by the Board of Directors to gas sales and purchase contracts acquired as of August 31, 1930, as a capital contribution."

* * * * * * * *

[fol. 10511] Trial Examiner: The question was not completed. You may complete it.

By Mr. Chamberlain:

Q. (Continuing) What amount of write-up is contained in the item of $2,417,948.52?

A. Will you define "write-up," please, sir?

Q. Yes. I will define it as the increase in the ledger cost of the plant and equipment over and above the actual cost of that property.

A. This witness does not know what the actual cost was, Mr. Chamberlain, and if I may suggest, we went over

this in rather complete detail when this witness was under cross-examination by Mr. Gorman. You may recall Table No. 2 appearing on page 17 of the Federal Trade Commission report, for this same series of questions was brought into play then.

* * * * * * * * * * * *

[fol. 10520] Recross Examination.

By Mr. Littman:

Q. Mr. Watkins, will you please turn to your Exhibit No. 250 which deals with the rate case expenses. I want to ask you one or two questions that I had forgotten to ask when you were last on the stand.

Calling your attention to the column headed, "Estimated To Complete," in the total amount of $135,101.05, can you advise us with respect to what is meant by the term "complete"? Does that mean to complete to the end of the present proceeding or to complete through any subsequent phases or proceedings that may or may not be contemplated?

A. It was the intention, Mr. Littman, when Exhibit No. 250 was prepared, that Column C carrying the heading, "Estimated To Complete," would portray our best judgment of the additional expenses not heretofore actually [fol. 10521] recorded necessary to carry the present proceeding to what now appears to be its final completion.

Q. Before the Commission?

A. There is no particular consideration given in these estimates, as far as the witness knows, and most of the estimates are of the witness, with respect to any side issues in the matter.

Q. How about Courts of Appeal? That might help bring to a head what I am driving at.

A. There may have been some slight consideration given to the possible matter of appeal but, if so, it is so slight that it hardly would be noticeable in this estimate.

Q. In other words, you are saying that you have not included in Exhibit No. 250 any estimated costs of carrying this cause through any appellate courts if any such occasion arise?

A. I might have been swayed to some extent by wishful thinking because certainly we and the Commission should avoid some such thing as that if it were possible at all to do it.

The answer to your question is no.

Trial Examiner: May I ask, Mr. Watkins, whether your subsidiaries include Michigan Gas Transmission Corpora-tion?

The Witness: Yes, sir. This amount of $350,000 shown by Exhibit No. 250 includes the actual expenditures of Pan-handle Eastern and Michigan Gas Transmission Corpo-[fol. 10522] ration to February 28, 1942, and the estimate on behalf of not only those two companies but the expen-ditures of any of the other subsidiaries should there be such expenditures from that time to the completion date of the matter.

By Mr. Littman:

Q. Now, does the amount of $135,000-odd labeled "Esti-mated To Complete" cover all services estimated to be ren-dered subsequent to February 28, 1942, up to which latter date you have included the actual cost? Have I made my-self clear, Mr. Watkins?

A. I am afraid not, sir.

Q. Well, perhaps I can state it a little differently. Does your Column B headed "Actual to February 28, 1942", in the amount of $214,898, cover all services that were ren-dered to that date?

A. No, it does not, but, to the extent that it does not, $135,101.05 shown as a total of Column C opposite line 13 does include any unpaid services at February 28, 1942, plus any we estimate that would be incurred subsequent to that date. The $350,000, therefore, would include such items.

Q. That helps me, in part, Mr. Watkins, but to be per-fectly clear about it, can you give me some idea of the period of time covered by your estimated Column C, generally?

A. Well, my memory runs to this fact, that in the prep-aration of the estimate shown in Column C, at that time [fol. 10523] we understood we were to come back here last week and clear up any further examination in the matter. There was then before us the necessity of briefing and whatever additional work of that nature had to be done be-

fore some final decision was rendered by the Commission, and our $135,101.05 contemplated substantially that program.

Q. Well, I want to be sure about this. Are you saying that the $135,000 covers substantially the services which you just described and none other?

A. Well, I have tried, in response to some of your questions, to cover probably more than the immediate answer did.

There are some charges and were some charges on February 28, 1942, that had not been presented to the company.

Q. Were they substantial?

A. Some of them, I think were, but, even if they were, they are not included in the $135,101.05, and, likewise, in the $350,000.

Q. And even if they were not substantial, they are still included in the $135,000 figure, is that right?

A. If they were not, that is to say, that any charges not actually presented at February 28, 1942, and, consequently, not included in the items shown in Column B, are included in the estimates shown opposite the respective line numbers and captions in Column C.

Q. Well, just this one further question which I think [fol. 10524] may clarify the matter a little further. Can you state approximately how much this estimated cost of $135,000 is attributable to services rendered in connection with this hearing subsequent to February 28, 1942?

A. That is to say, services to be rendered subsequent to that date?

Q. Yes. Now, if you want to give us an estimate and then check it later and supply the data in more exact detail, of course you may do so when you submit Exhibit No. 250-A. A. It will be a wild guess.

Q. Well, let's have it.

A. I should say that between $75,000 and $100,000 of the total opposite line 13, Column C, represented services yet to be rendered at the time the estimate was made.

Q. That is, yet to be rendered subsequent to February 28, 1942?

A. No, sir, I would have to change that because, if we are going to tie ourselves down to February 28, 1942, you

will recall that when this exhibit was presented, the witness stated that ~~there~~ had been some charges presented in the month of March, in the early part of the month of March, which had actually been recorded as a part of February work but had not actually been paid until in the month of March.

Now, there were likewise some charges which came in subsequent to the recordation of those charges which did [fol. 10525] not get in February work and consequently are in March work.

Q. Do you remember whether those amounts were substantial?

A. What I am trying to show, Mr. Littman, is that for services to be rendered, let's say, subsequent to February 28, it would be my judgment at the present time that of the \$135,101.05, not more than \$75,000 to \$100,000 would represent charges covering services ~~to be rendered~~.

Q. In [other] to assist in clarifying the matter of the estimated Column C, I am going to ask that you state, in connection with your estimated amounts, the same detail as that which ~~you had~~ planned to give us which was heretofore requested with respect to Column B contemplated to be submitted in Exhibit No. 250-A. Perhaps you already have that?

A. We had it in mind, sir, but our estimate will not relate to individuals. Exhibit 250-A, which is in the course of preparation, will, so far as the factual matter shown in Column B is concerned, relate itself to the person rendering the service and the type of service rendered, in the manner in which counsel heretofore asked for it. The estimates shown in Column C, for example, relate themselves to the general subject, such as other special services shown opposite line 6, and not necessarily relate themselves to the individual who performed the service.

Q. Didn't you estimate the amounts in Column C by [fol. 10526] individuals?

A. We may have approached it from that angle and then tempered it to some extent by our inability to correctly guess what charges might be rendered by one individual and what might be rendered by another individual.

Our judgment here was that these possibly were the limit, or maximum, rather, of the additional charges that

would be rendered. We might miss it a few thousand dollars as to one person and err on the short side as to another person.

Q. Will you give us a brief statement for the record at this time as to the manner, generally, in which you estimate the amounts in Column C?

A. Well, Mr. Littman, we have a rather complete record of the actual costs incurred to February 28.

Q. 1942?

A. That is correct. We have in our mind's eye a rather complete picture of the time and effort put forth with respect to such charges. We have gaged, to the best of our infirmities, what may be the time involved in the future by the various individuals and what might be their charges therefor. This estimate represents our best judgment of what future charges there might be to complete these proceedings.

Q. Am I correct in understanding that you made these estimates primarily?

A. Largely, yes, sir.

[fol. 10527] Q. Did you, in arriving at the estimated amount in Column C, ask your various experts to submit to you their estimates of the amount of their bills contemplated to be rendered in view of the services which remained subsequent to February 28, 1942?

A. No, sir, we did not and I did not personally because I knew we would not get any sort of an answer that we could use. You being an attorney would know pretty well, had we asked those dealing with this matter from the legal side, that they would have no basis upon which they could make such an estimate. The same thing is true with people rendering special services. If we could lay down in front of them the actual work they would have to do, and the time involved, they might be able to do it, but, to my judgment, it would be of no avail, it was expensive, and it would be a costly way to get nothing.

Q. In other words, this Column C represents your estimate—

A. (Interposing) Not entirely mine, no, Mr. Littman. I am the prime mover behind the estimate but I did not put it in here alone. It has, I am sure, the complete concurrence of the organization, generally.

Q. Perhaps I should avoid the difficulty that you apparently have in mind by saying this estimate is the estimate of your organization, of you and your organization? A. Yes.

[fol. 10528] Q. And not the estimate of the individuals who rendered and will render the services subsequent to February 28, 1942, or thereabouts?

A. That is correct.

* * * * * * * *

[fol. 10529] Trial Examiner: The question the Trial Examiner asked was simply to ascertain whether we all understand this Exhibit No. 250-A which is in the course of preparation is to become a part of the record and available to all counsel.

Mr. Littman: That is right.

* * * * * * * *

[fol. 10530] The Witness: At page 9855 of the transcript of proceedings for April 15, counsel for the Commission asked that a reconciliation of an item of $7,350,000 and some similar amounts for the subsidiaries of Panhandle Eastern included in Exhibit No. 202, I believe, and possibly Exhibit No. 243, be prepared and submitted, and the witness was about to ask, before leaving the stand, whether or not it would expedite matters if an exhibit number was reserved for those items and we let them take the same procedure as Exhibit No. 250-A is about to take.

[fol. 10531] Mr. Littman: Yes, I think that is an excellent suggestion and I am going to ask that an exhibit number be reserved for these data.

Trial Examiner: That may be done.

Mr. Littman: One exhibit number will be sufficient, won't it, Mr. Watkins?

The Witness: Yes. If there is more than one sheet, we will tie them together.

* * * * * * * *

Trial Examiner: The exhibit which will be prepared in accordance with the specifications stated will be numbered

Exhibit No. 257 and it is understood it will be received in the record after the conclusion of the hearing.

* * * * * * * * *

(The Data Referred To, When Received, Will Be Marked Exhibit No. 257, And Will Be Received In Evidence.)

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[fol. 10534] P. McDonald Biddison a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Recross-Examination (Resumed)

By Mr. Chamberlain:

Q. Now, Mr. Biddison, the basis of your Exhibit No. 251—

A. (Interposing) Mr. Spacek's exhibit, please, sir.

Q. Well, we will start over again.

Now, the method of allocation exemplified and reflected in Mr. Spacek's Exhibit No. 251, the plan for which was formulated by you, contemplated, does it not, that the direct industrial sales do not contribute to the requirement of the provision for capacity upon peak days?

A. That is correct.

Q. Now, I quote from the transcript of your testimony on page 10018, your answer being the first one on that page is as follows:

"No, nor have I so estimated any such thing as that."

Perhaps I had better read the question before that. The question immediately before is this:

[fol. 10535] "Is this a fair statement, then; that it is your thought in your testimony here that the pipe line company has a right to take such gas as it wishes to sell on direct industrial sales, and to utilize the entire transmission facilities of the company without any return upon them, and still have their income taxes paid at these high rates as a charge to the public for the gas they get through those same transmission facilities?

"Answer: No, nor have I so estimated any such thing as that. I do think that they are entitled to transmit gas for

direct sales without allocating part of their capacity against those direct sales, so long as those direct sales don't entail the construction of property. If they entailed a construction of capacity, they certainly ought to bear the cost of the capacity."

Following that, the question was:

"Question: A few months ago, did they not have to shut off some of their customers on account of a lack of capacity?

"Answer: Yes, sir, they did.

"Question: Well, then, somebody required some capacity, didn't they?

"Answer: Yes, sir, they did, and during that period of cutoff which I have studied, I reached the conclusion fortifying my knowledge that they don't build capacity for this class of business that they had then no capacity for this class of business, and have none now for this class of [fol. 10536] business."

Do you recall that?

A. Yes, sir.

Q. I wish, to clarify your position a bit, that you would elaborate a bit upon the fact that you have stated that they have now no capacity for this class of business. What do you mean by that?

A. Well, I mean the facts, as I related them in subsequent testimony along that same point the same day and time which you referred to in the record.

Q. Do you mean that they have no capacity now for direct industrial sales?

A. I mean that their capacity is required for indirect sales and that more capacity is required to meet the demands of indirect sales than they have in the system.

Q. Is it your thought that direct industrial sales require no provision for capacity and that the indirect sales made under the same conditions do require the provision of capacity?

A. No.

Q. Well, the interruptible sale, whether it be direct or indirect, is of the same general class, is it not, in respect to the matter of a provision for capacity?

A. Yes.

Q. And neither one should be sold provided that capacity has to be built for them, should they?

[fol. 10537] A. That is right.

Q. Now, did I understand that you made a study of this company to determine whether or not it had made any construction to take care of these industrial sales?

Mr. Wheat: You mean direct industrial sales?

Mr. Chamberlain: Direct and indirect, interruptible sales.

The Witness: I have checked over their capacity calculations in advance of making extensions and betterments to their system upon several occasions, beginning back, I believe, in 1937 and it is not their custom to make provision for capacity for the delivery of the interruptible gas upon peak days.

By Mr. Chamberlain:

Q. That is, it has not been their custom to do that?

A. That is right.

Q. Now, let me ask you a question, if I can, in a concrete way to get your theory of when these sales should be discontinued for a lack of capacity.

Let us assume that at the present time the capacity of the line, and I will have to use it as the entire line, is 250 million feet per day. The demand for firm gas is increasing. When and how should these sales be handled? Should new construction be made to provide for them or should they be discontinued?

A. Neither one.

[fol. 10538] Q. Well, all right. Now, what would you do?

A. I would just make such of those sales as I could make.

Q. In other words, you would discontinue all of those sales except those that you could handle without using your peak capacity, is that right?

A. I would sell all of the interruptible gas I could sell at a price that made an earning above its cost. I would

sell it at an interruptible basis and at a rate predicated upon interruption and I would interrupt it when the capacity required it for the firm business.

Q. Then you would get more nearly into what you described yesterday as a dump sale, would you not?

A. No, you would continue making sales just like Panhandle is making to these industries and just like most other gas companies I know of do make.

Q. Then you did make a study to see how much and how often Panhandle had interrupted these contracts they now have and which you have listed as direct industrial sales?

A. I have investigated the cut-offs on it, yes.

Q. And how many years did they run without a cut-off, that is, before the first cut-off?

A. I do not know.

Q. You did not investigate that?

A. No.

Q. What period did you investigate?

[fol. 10539] A. Well, I investigated, in this instance, the winters of 1940-'41 and 1941-'42.

Q. How many were cut off in the winter of '40-'41?

A. I haven't recorded that. I could not tell you now.

Q. It was not of any particular length of time, was it, that there was any cut-off?

A. Well, there was a material cut off in February, 1941.

Q. And what was that?

A. February, 1941.

Q. What was the cut-off, though? What company was cut off on your list?

A. Well, I haven't [it] tabulated it that way so I cannot answer that question.

Q. Then you did not make a completed study, at least, of the length of time that these direct industrial customers had been cut off or the number of times?

A. That is right.

Q. Now, as a matter of practice, not only with this utility but others that you know of and to which you have referred, has it not been a practice to carry these interruptible sales very steadily, in other words, to rather give them service due to the fact that they are interruptible, rather than to treat them as a sale which they cut off on days of great demand?

A. No, sir, that is not the case although I do believe [fol. 10540] that there have been instances where the right to cut off has not been enforced.

Q. And there are many of these businesses which would be unable to use gas if it was cut off frequently, is there not?

A. I think possible that is true.

Q. What study did you make to determine whether the company had expended any money for construction to carry these industrial sales, the interruptible sales?

A. Well, as I say, in the past, I have checked their calculations for capacity in advance of construction and know the peak loads for which they designed and the composition of those peaks and I know there was no provision in them for the interruptible sales to be carried through peaks.

Q. Well, when did you begin to make those checks, Mr. Biddison?

A. I began to make those checks in 1937.

Q. And what was the last one you made?

A. Sometime last year.

Q. In other words, you checked last year the contemplated construction expenditures of Panhandle Eastern?

A. I did.

Q. And there was nothing—

A. (Interposing) That is, I checked their estimates for capacity. I did not check the estimates of money.

[fol. 10541] Q. No, but you checked the question of the necessity of construction of additional construction, did you not?

A. I checked the estimates made of capacity to be provided for against the loads to be cared for.

Q. And in studying the load you had, of course, the amount of the industrial sales, did you not?

A. Yes, the peak loads on it.

Q. That is right. You would have to have the peak loads on the industrial customers, would you not?

A. Y.

Q. And you had that?

A. Yes, sir.

Q. Do you have those files?

A. No, those files are the files of Panhandle Eastern Pipe Line Company in Kansas City.

Q. I see, and they show then what the contemplated need for the extensions and improvements of the line are, do they not?

A. Yes.

Q. Now, were you not here when Mr. Morton put in his exhibit early in the hearing in respect to the pipe line capacity and the future improvements that were contemplated?

A. I have been here when Mr. Morton testified on some matters but I do not think I was here when he testified on matters of that sort.

[fol. 10542] Q. Well, do you remember what the peak day was, the maximum day, and I mean the system days, in 1941?

* * * * * * *

Mr. Chamberlain: I am asking about the peak day of the system, not about the company contract.

The Witness: I think the peak day that year was 240,394,000 of sales.

Q. That is right. Now, what part of that capacity was reserved and used on that peak day for industrial sales?

A. I do not know. I do not have it tabulated.

Q. Do you have near you Exhibit No. 40?

A. This tabulation you placed before me does not bear on that.

Q. It doesn't? Line C of Exhibit No. 40 shows the actual maximum demand on the day of the system's maximum demand in 1941; does it not, and didn't Mr. Morton so testify in your presence?

A. I do not think he testified in regard to this exhibit in my presence. I do not remember anything about it and [fol. 10543] never saw it before.

Q. Well, this exhibit shows and I ask you to confirm, if I am not quoting it correctly, that the maximum day for the system in 1941 was, as you have indicated, 240,394 M. c. f.; that on that day, the maximum take of the Detroit area was 102,604 M. c. f.; that for domestic, commercial and other sales east of Dana, it was 1,384; that the industrial demand in Indiana and Ohio was 27,708 M. c. f.; that

the other use in Indiana and Ohio was 28,676 M. c. f.; Kentucky Natural Gas maximum was 7,608, making the total east of Dana of 167,980 M. c. f.

Then it shows that the maximum day's take of industrial gas west of Dana was 38,400 M. c. f.; that the domestic and commercial for that area was 34,014. Is that not correct?

A. You have read the figures correctly from the list.

Q. Yes. Then if the exhibit—or do you want to figure that?

A. What is the question that is pending?

(Whereupon, the pending question was read by the reporter.)

The Witness: That is correct.

Q. Then on the maximum day, the industrial loads in Indiana and Ohio and west of Dana amounted to 66,108 M. c. f., did they not, of the actual capacity of that line?

A. Well, it is 27,708 plus 38,400 M. c. f. which [—] 66,108 M. c. f. out of 240,394 total peak.

[10544] Q. All right. Now, what per cent was used of capacity for industrial gas of the total peak load?

A. About 27½ per cent.

Q. Well, how do you account for the fact then that no construction was made to take care of this industrial load, if, as a matter of fact, it took 27½ per cent of the entire maximum demand?

A. Well, construction was made to meet the obligation of Panhandle Eastern Pipe Line Company for the Detroit market to the extent of 125 million feet [and] day and they did not use it on that day.

Mr. Culton: Does that exhibit make any difference in industrial between interruptible and firm?

The Witness: It does not.

Mr. Culton: Or between direct and indirect?

The Witness: No, sir.

By Mr. Chamberlain:

Q. Is there anything in the Detroit contract which contemplates that the Detroit company will take their maximum day on the day of the system's maximum day?

A. Not that I know of.

Q. Would there be any reason for you to think that it would necessarily be upon the same day?

A. Yes, ample reason for it. It is a normal expectation.

[fol. 10545] Q. You would normally expect that?

A. Yes.

Q. Has it ever happened?

A. I do not know whether it has ever happened or not. I know there have been occasions on a maximum day when they did not take their peak takings.

* * * * * * * *

Q. Have you been called upon to check or pass upon the expenditures for the future for Panhandle Eastern Pipe Line Company? A. I have not.

Q. Now, will you check Exhibit No. 40 and give us the percentage that it is contemplated the industrial sales will take of the maximum capacity which is to be provided for by that date?

[fol. 10546] A. Well, I do not know what maximum capacity was being provided for that date.

Q. Assume the capacity provided for is that necessary to distribute the amount of gas and in the method indicated by Exhibit No. 40; the column being Column H and made up the same as Column C which you have just computed?

A. Well, Exhibit No. 40 shows a total maximum day of 305,200,000 which is 55,200,000 in excess of the capacity of the system so that amount of gas cannot be served during the year 1942 by Panhandle Eastern's system.

Q. I am not speaking about 1942 at all. I am asking you about the year 1946.

A. The year 1946, the maximum day shown at the bottom of Column H is 441,900 M.c.f. How much of that is proposed to be served or how much capacity they propose to build for it, I do not know.

Q. I am going to ask you to assume that it is proposed to build such extensions and additions of pipe line as will serve the amount of gas indicated in Column H of Exhibit No. 40 which is 97,589,200 M.c.f. with a maximum day of 441,900 and I would like to know the percentage of that that is evidently allocated to industrial sales?

A. Well, industrial sales shown are 10,040 M.c.f. east of Dana and 47,500 M.c.f. west of Dana or 47,540 M.c.f. out of 441,900 M.c.f. The ratio is about 13 per cent.

[fol 10547] Apparently there is a figure omitted there. Did you get the 41,700 of industrial for Indiana and Ohio?

A. No, I did not and that adds 41,700 to the total, making 99,240 M.c.f. out of 441,900 or a ratio of about 22½ per cent.

Q. Then if in the exhibits in this case there is a showing of the amount necessary for construction for the sale and delivery of industrial gas to the extent of 22½ per cent, it is contrary to what you have understood their policy and history to be, is it not?

A. I will say that is absolutely contrary to what their previous policy and action has been.

Mr. Culton: Do you find anything there showing they expect to furnish that much interruptible gas on peak days?

The Witness: No.

Q. That is interesting. I would like to ask you to make another computation.

Let's take Column C and now refer first to Exhibit No. 55 and I shall ask you to assume that the gentlemen, in estimating the sales for 1941, were substantially correct and this includes only those sales to customers who take over $20,000 per year. The quantity is shown in Column L.

[fol. 10548] Now, will you deduct from that the amount of the direct industrial sales less the sale to Anchor-Hocking which is not included in that exhibit and see how much of those sales are indirect?

Mr. Wheat: Was that question clear, Mr. Biddison?

The Witness: I think I know what he wants.

Well, the direct industrial sales for the year ended December 31, 1941, shown by Exhibit No. 251 at line 6 was 6,525,609 M.c.f. If we deduct that from the 20,779,710 M.c.f. shown in Column L at line 40 of Exhibit 55, you

have a difference of 14,274,101 M.c.f. Now, I do not know what to label that.

By Mr. Chamberlain:

Q. Well, all right. Are we making any—

A. (Interposing) It is hardly fish nor fowl. It is the difference between two figures that are not compiled on the same basis.

Q. Well, now let us see, are we making any error in the Anchor-Hocking sales?

A. Well, Anchor-Hocking sales is included in the 6,525,609 M.c.f.

Q. Then the result of your computation is to ascertain those sales which are indicated on Exhibit No. 55 to be indirect sales after placing Anchor-Hocking in the direct sale class; is it not?

[fol. 10549] A. No, all I can say is that it just represents the difference between those two figures. The 6,525,609 M.c.f. of direct industrial sales, including Anchor-Hocking, includes all direct industrial sales regardless of their size while the figure of 20,799,710 M.c.f. is, as I understand it, restricted to customers over a certain size.

Q. Of course, all of your direct industrial sales are far over that restricted size, are they not?

A. Well, I do not know on that.

Q. You do not know about that?

A. No, sir, I do not.

Q. Would you mind looking at them on Exhibit 55, all appearing in the first eight lines?

A. Evidently not.

Q. They are all very large ones, are they not?

A. Those that are listed are large but there are a number of those direct industrials that are not listed there.

Q. Small ones, aren't they?

A. Well, I do not know how small they are because I do not have their consumption before me.

Q. All right. Well, you have no question about the fact that there was sold in 1941 approximately 20,799,710 M.c.f. for industrial purposes all as set out in Exhibit No. 55, have you?

A. No, I do not question the figure.

[fol. 10550] Q. You have found the amount of direct industrial sales and, by subtracting that, you find 14,-274,000 of indirect industrial sales, do you not?

A. No, sir, I do not at all. I just find the difference between two figures of 14,274,101 M.c.f. It is a difference between two figures. The two figures are not compiled on the same basis. The big figure does not contain some of the customers that are contained in the smaller figure and what the thing means when you get that kind of a difference, I do not know.

* * * * * * * *

[fol. 10551] Q. Mr. Biddison, all of the industrial sales which you determined to be direct industrial sales and named in your letter of April 8, 1942, to Panhandle Eastern were sales which occurred west of Dana, were they not?

A. No, sir.

Q. With one exception? A. That is correct.

Q. And that was the Anchor-Hocking sale made by the Indiana Gas Distribution Corporation, was it not?

A. That is right.

Q. Now, that is indicated in Exhibit No. 55 as an indirect sale, is it not?

A. Yes, sir, it is so shown in Exhibit No. 55.

Q. The reason for that was that until the last two or three months, Indiana Gas Distribution Corporation was not affiliated with Panhandle Eastern, is it not?

[fol. 10552] A. That is correct.

Q. And when you prepared your letter of April 8, 1942, that company was an affiliate of Panhandle Eastern?

A. That is true.

Mr. Colton: You mean a subsidiary, don't you?

* * * * * * * *

By Mr. Chamberlain:

Q. Now, Mr. Biddison, I want to refer to Exhibit No. 162 which is the working papers of Mr. Morton and which show a division between the direct and the indirect industrial sales west of Dana. This is shown on page 8, working sheets, W. S. No. 8. Now, that gives the indirect industrial sales for the year 1940 as approximately 7 million M.c.f., does it not?

A. It does.

Q. And 4 million of direct sales, direct industrial sales west of Dana, is that right? A. That is right.

Q. It also shows the actual sales for the first six months of 1941, does it not?

A. For those two classes of business, yes.

* * * * * * * * *

[fol. 10553] By Mr. Chamberlain:

Q. And I am going to ask you to take the sales of industrial gas for 1941 indicated on Exhibit 55 and deduct from that the amount that you now find to be direct industrial sales. That computation you have already made and, if I took your figure correctly, it was about 14,700,000 M.c.f.

A. The difference between those figures is 14,774,101 M.c.f.

Q. That is right.

A. Now, that is a mere mathematical result from making the subtraction.

Q. That is right.

A. When you subtract 20 million horses from 6 million bananas, you have got 14 million something but you don't know what and I don't know what this 14 million plus is.

Q. No, I realize that and, furthermore, when I ask you to subtract horses from bananas, you will be older than you are now, but I am asking you to make a subtraction.

[fol. 10554] Now, will you, in order to find the contribution that would be caused by that amount of gas, assuming all of the direct industrial to be west of Dana except that of Anchor-Hocking and determining the load factor, will you tell us what the contribution there to the maximum day of 1941 was of that amount of gas?

A. I cannot determine it from this figure. This is not the figure to use.

Q. Now, you can determine the mathematics of that, can you not?

A. Well, we are dealing now with meaningless figures. I will add, multiply any of them you say and you label what you want to but I am going to have to say I do not know what they are.

Q. That is all right. You have said that before. I am merely asking you to make the computation, Mr. Biddison.

A. What computation am I to make, then?

Q. I would like to find the contribution of that industrial load of 14,274,101 to the maximum day of 1941:

A. I have no information available to me here from which I can make any such determination.

Q. You have the information in front of you to find the load factor of all of the industrial gas that is reflected in Column C of Exhibit 40, do you not?

A. I have before me information on which the load [fol. 10555] factor on the industrial sales listed in that column can be determined, yes.

Q. All right. Now, you can tell what the contribution of the maximum day was from that, can you not?

A. Yes, for that gas.

Q. All right. That is a start, isn't it?

A. Not towards what you asked for, it isn't.

Q. What did you say?

A. Not towards what you asked for, it isn't.

Q. Yes, it is. Now, the special industrial gas or the indirect industrial gas is all in the chart west of Dana, is it not?

A. Yes.

Q. All right.

A. Except for Anchor Hocking.

Q. That is right, except for Anchor-Hocking. Now, the Anchor-Hocking gas is one billion feet out of a total of 10¼ billion feet, is it not?

A. Well, in 1941 it shows on Exhibit No. 55 to have been 1,267,974,000.

Q. That was the estimated figure which is now corrected by the actual figure which you have used but it is approximately right. You say you cannot make that computation?

A. No, I cannot take 14 million feet of gas, the classi- [fol. 10556] fication on which I do not know, and relate it to a peak on here that is specified to a particular character of gas.

No, I cannot do that and neither can anybody else.

By Mr. Chamberlain:

Q. Now, I want to inquire a moment about the allocation that you directed of the Federal income and excess profits taxes. You have taken substantially what you say is the increment cost of the gas. Why did you not use that increment cost of the Federal income and excess profits taxes?

A. Well, I did not use it because on the rest of it I did not approach it from an increment basis. That would be one reason for not applying an increment cost to Federal income taxes. Another reason for not applying increment cost to Federal income taxes is this: The amount of taxes is fixed by the amount of taxable dollars and I think its proper allocation is over those dollars regardless of source.

Q. And you did not think that the proper allocation [fol. 10557] of the taxes would be to charge to the non regulated business the amount over and above the average tax on those dollars?

* * * * * * * *

The Witness: I do not know what that amount would be, Mr. Chamberlain. I do not understand you on that question at all.

* * * * * * * *

Q. Let me approach it this way, Mr. Biddison. You are allocating to the non-regulated business merely the costs that pertained to the production facilities plus those of the—well, I should not say as a matter of operating costs—you are apportioning operating costs but you are apportioning to the return only the proportionate part used of the operating facilities plus the small amount of laterals and regulating and metering equipment that is wholly owned.

Now, you allocate to that nothing for the use of the transmission facilities. Why do you not assume then that the revenues obtained from that gas are additional to the regulated business and apply to them the tax upon the last dollar earned or upon the higher brackets of this income?

A. Because they are not the last dollars earned. They are earned concurrently with the other dollars.

[fol. 10558] Q. And earned without expense for transmission?

A. No, not without expense for transmission.

Q. Earned without expense for return to the transmission facilities?

A. Well now, I have not proposed that, Mr. Chamberlain. I have made an allocation of the costs and I have suggested that there be a charge made.

Q. That is, your recent suggestion was that there be a charge made?

A. Yes, sir, for the use of those facilities on which the transmission and sale of this gas produced no costs.

Q. Well, conceding that you made a different allocation, would you still say, as you have in Mr. Spacek's Exhibit No. 251, that the Federal income and excess profits taxes should be allocated proportionately rather than that the higher brackets of the tax should be levied against the non-regulated business?

A. I would still think that that tax should be allocated in proportion to the amounts in the various classes of accounts subject to tax.

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[fol. 10559] J. D. Creveling a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Redirect Examination

By Mr. Culton:

Q. Mr. Creveling, a few days ago Exhibits Nos. 223 and 224 were offered in connection with the testimony of Mr. Hinton relating to capital expenditures south and west of Liberal compressor station to meet peak day sales of 307,000 M. c. f. and a substitute estimate of additional capital expenditures required to meet peak day sales of 338,000 M. c. f.

Exhibits were also offered in that connection by Mr. Hinton which, I believe, were Exhibits Nos. 225, 226, 227 and 228 relating to the costs of operation and maintenance south and west of Liberal compressor station under differ-

[fol. 10560] ent capacities, the capacity factors being on the basis of 307,000 M. c. f. and 338,000 M. c. f. with some tables relating to the economic expense of operation and maintenance and some to less economic expense of operation and maintenance. In the same connection, Mr. Burnham offered Exhibits 229, 230 and 231 relating to estimated expenditures required on the system for these respective capacities and these gentlemen testified that they made their estimates under your instructions as president of Panhandle Eastern.

Will you explain to the Examiner, for the purpose of the record, the reason for directing that investigation and study to be made?

A. Normally by this time in the spring, we would have made and ready for consideration tentative construction programs for the coming season. Last year, we made such an estimate and were in a position to start work on that about the first of May. Because of inability to obtain material, which was no fault of our own, we were unable to start that construction work until late in the fall, the latter part of October, as I recall, although contracts had been made for material, contracts had been awarded to successful bidders and contracts had been made for the sale of gas.

As a result of our inability to obtain materials in time to be of any assistance at all in our 1941-1942 winter [fol. 10561] through which we have just passed, we were compelled as a matter of safety and precaution, in order to be able to render service to those of our customers to whom we are obligated to render a firm service, to discontinue or curtail certain of our services to industries. Certain of those industries were or considered themselves, at least, engaged in activities closely related to the war program.

When we saw that we were not going to be able to have these facilities in operating during the winter of 1941-1942, we sent a representative of the company to every one of the industries that it was at all probable we might have to interrupt service in the case of extremely cold weather. Certain of those industries were curtailed in the month of January and, although a representative of one industry that I have in mind, in particular, stated that he would

rather take a chance on having his fuel curtailed or completely interrupted for a few days rather than to put back into service his oil burning equipment, he was one to complain most loudly to O. P. M.

Mr. Wheat: You mean when there was a curtailment?

The Witness: When there was a curtailment.

This resulted in my being called to Washington to account for this curtailment of service which I think I did to the entire satisfaction of those to whom I talked.

Mr. ~~Littman: Pard~~on me, may I interrupt to ask the name of this particular customer?

[fol. 10562] The Witness: The A. P. Greene Fire Brick Company of Mexico, Missouri.

Mr. Littman: Do they manufacture brick?

The Witness: Fire bricks in various shapes used largely in boiler and steel industries.

Mr. Littman: I see, thank you.

The Witness: Recognizing the fact that we were again, during the coming winter, going to be faced with a proposition much more acute than the one of the winter through which we have just passed and being desirous of being in a position at least to have said, in case a program outlined was not carried out, that we had outlined to the War Production Board or the proper Governmental authorities what we thought we could do if it was a real contribution to the war efforts of the country. Also, through rumors and piecing together such items as a questionnaire sent out by the Federal Power Commission and from comments and questions asked by at least one member of the staff of the Federal Power Commission and from conversations with various members of the W. P. B.—

Mr. Wheat: (Interposing) You refer to the War Production Board, do you?

The Witness: (Continuing)—the War Production Board, I came to the conclusion that Panhandle Eastern Pipe Line [fol. 10563] Company was going to be called up to make a contribution in the way of fuel that we had not yet been

told about. From various items I was able to gather, it appeared to me that we might be asked to curtail certain of our regular business and divert certain gas going into our regular channels to other markets east of the territory that we then served to the extent of possibly 75 million or 100 million cubic feet per day.

For all these reasons and being cautious through experience and not being anxious to be caught napping, in order to be in a position to promptly answer any proposition that might suddenly be put up to us as to what we might do in the way of a fuel contribution to the war industry, I asked that certain studies be prepared, first on the basis that we would normally do this expansion work if there were no limiting or hindering influence. This first study and the one that we would normally follow, called for about 60,000 tons of steel.

By Mr. Cullon:

Q. By steel, you mean pipe?

A. Steel in the form of pipe and certain compressors and other equipment.

From my continual discussions with the War Production Board representatives, I was fairly well satisfied, and also from what I read in the papers, that for a small company [fol. 10564] like Panhandle Eastern to go in and take away from the various war activities 60,000 tons of steel was probably out of the question even though we would thereby contribute fuel to the amount of possibly 90 to 100 million cubic feet per day additional.

Hoping that such a program would be approved but being quite certain in my own mind that it would not, I asked our engineers to prepare a study on the basis that the same peak day could be met but that would limit the amount of steel in the form of pipe to not to exceed half of the 60,000 tons or to 30,000 tons. I was first told by their looks, if not by their words, that I was crazy. I would not admit it for that reason, at least, because a study which is the so-called less economic study indicated by adding additional compressor facilities, by taking gas from the longer life reserves of our two fields, adding cost in excess of that from which we would first normally produce it, there-

by increasing our operating costs by three or four hundred thousand dollars—

Q (Interposing) Per year?

A. Per year, as a temporary expediency, such a program was within the realm of feasibility. We could be in a position to deliver to our markets, as we estimated they might exist, 338 million cubic feet per day with 30,000 tons of steel or less.

[fol. 10565] To be even surer that we had gone the limit in analyzing our possible expansion as a contribution to the war efforts, I asked our engineers to proceed with another study which would permit us to deliver daily 307 million cubic feet or gas to our markets as we then saw them to exist or to markets which we might be told to substitute for the potentially existing markets. This would permit us to deliver daily some 55 to 60 million cubic feet more than we can continuously at present do. That is the study No. 3 referred to as the 307 million study and consists simply in the looping of the balance of our main lines, adding some loops to the Michigan Gas Transmission Corporation and a small amount of pipe in the Hugoton Field but does not consist of the major item of looping that was contemplated in Study No. 1.

All these studies have been in the recent past discussed with the War Production Board. My surmise, if it were a surmise as to Study No. 1, apparently was correct because I was told that it was an impossibility or at least seemed very improbable that there was any chance of our getting 60,000 tons of steel for pipe but that the one involving 30,000 tons or less was a very realistic one, one in which the War Production Board was vitally interested and one on which conferences are now being held.

Mr. Littman: Pardon me, Mr. Creveling. You just re-[fol. 10566] ferred to Study No. 1. Will you please give us which one that is?

Mr. Culton: That is the economic method, is it not?

The Witness: If I refer to studies by number, in order to make the record clear, I shall call No. 1 the 338 million per day economic study—

Mr. Littman: (Interposing) Pardon me, I don't want to interrupt except for purposes of clarification—

The Witness: (Continuing)—for the load factor has nothing to do with the study.

Mr. Culton: That was No. 230.

I will state for Mr. Creveling's information that the study showing the 338,000 capacity, completely looped and economically powered main line system with economic production transmission expenditures is Exhibit No. 230.

The Witness: That is No. 1.

Mr. Culton: The same capacity with less economic production transmission expenditures is Exhibit No. 231.

The Witness: That I will refer to as Exhibit No. 2, if at all.

Mr. Culton: And the study showing the daily delivery capacity of 307,000 completely looped and economically powered main line system with economic production transmission expenditures is Exhibit No. 229.

The Witness: I should have used those numbers but I [fol. 10567] was not acquainted with them.

Mr. Littman: That is No. 3?

The Witness: That is correct.

For those principal reasons, I asked to have these studies made.

Mr. Littman: Do I understand you Nos. 1, 2 and 3 to be the order in which, in your opinion, there is likelihood that they will be adopted?

A. No, sir. Near the end of my statement, I said that I was of the opinion that there was no chance of the No. 1 study being carried out this year.

Mr. Littman: I see. I have them twisted a bit.

The Witness: Yes, but you are straight now. That is the one involving the 60,000 tons of steel or thereabouts.

Mr. Littman: Yes. In other words, these numbers do not bear any particular relationship to the likelihood of their being adopted?

The Witness: Not at all.

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By Mr. Culton:

Q. Which was the one you thought there was a good chance that it could be carried out?

A. No. 2.

Q. Which is the study of the 338,000 capacity?

A. The less economic 338 million per day which involves an increase in our operating costs of some three [fol. 10568] to four hundred thousand dollars a year.

Q. You said, I believe, that you had answered a questionnaire and also you had gained the impression that there had been some consultations between some of the staff of the Power Commission and some of the staff of the W. P. B. relative to Panhandle Eastern's situation in connection with furnishing gas further east.

Can you tell us how you understand that possibility would be effected or could be effected?

A. Yes. Panhandle Eastern's system, as it now exists and I use that in order to include the Michigan Gas Transmission at this time and that small piece of Ohio Fuel Gas Company line which we acquired—

Mr. Littman: (Interposing) Which lateral line runs from Muncie, I believe?

The Witness: To the State line.

Mr. Littman: To the Ohio Indiana State line or thereabouts?

The Witness: That is right.

The main pipe line system of the Panhandle Eastern Pipe Line Company, as it now exists, connects with the Ohio Fuel Gas Company at a point near the Indiana-Ohio State line substantially due east of Muncie, Indiana. It is also in the northwestern part of the State of Ohio, comes within about 14 miles of three Ohio Fuel Gas Company [fol. 10569] lines just south of Toledo but there is no con-

nection between Panhandle Eastern's system and the Ohio Fuel system at that point.

One of the thoughts advanced is that this 14 mile—

By Mr. Culton:

Q. (Interposing) Was that thought advanced by you or was it advanced by somebody else?

A. It was not advanced by me. It was advanced by the War Production Board.

(Continuing) was to connect Panhandle Eastern system with the Ohio Fuel system at a point near Toledo, Ohio. Through these two points of delivery, if we could get the gas there, we should deliver 75 to 100 million feet of gas per day which would take the place of gas produced elsewhere, principally in Ohio and West Virginia, for those markets and making that gas available for markets in the Appalachian area, principally the Pittsburgh area where it seems that there is or is about to be a severe shortage of fuel.

Q. There has been something in this record about Order L-31 of the W. P. B. Are you able to give us any views as to how its operation can or might affect Panhandle Eastern?

A. All I can answer about Order L-31 as to how it will affect Panhandle Eastern is that I do not know, except that it will affect it.

In Order L-31, one of the things that is suggested as [fol. 10570] possible is the exchange of gas between pipe line companies. The basis of exchange is not set out. We are certain of the fact our business is [stipped] from the standpoint of growth and by that I mean house-heating sales. Our industrial sales—

Mr. Littman: (Interposing) You mean new house heating customers?

The Witness: That is correct. Our industrial sales are limited or have a book of rules written for them. It is my judgment that it would be impossible at this time to predict with any degree of exactness the effect of Order L-31 on the business or revenue of Panhandle Eastern Pipe Line Company other than to say that from my recent talks with the War Production Board, I am convinced of the fact

that we are going to be asked to handle much more gas during the next twelve months than we had anticipated.

Mr. Littman: By Panhandle, you mean you are—

The Witness: (Interposing) Take it through our system for some place.

Mr. Littman: For sale, of course?

The Witness: Yes, that is right.

Mr. Littman: You are going to sell more gas?

The Witness: That is right.

By Mr. Culton:

Q. Do you have any idea as to what unit price you will be able to get out of that gas?

[fol. 10571] A. I have no idea.

Q. What is the present situation with respect to local gas in Michigan?

A. In connection with the possible development of more gas for war industries, consideration has been given to providing the Consumers Power Company with compressor station facilities which would permit them to handle, through their lines and ours now in process of construction—

Q. (Interposing) Who gave that consideration?

A. (Continuing)—not only gas for their peak requirements but possibly some gas in excess up to as much as 25 million feet per day.

Also, there has been drilled near Jackson, Michigan, one gas well by the Continental Oil Company which had an open flow of 10 million feet and, although a second well drilled by the Continental Oil Company on a block of acreage in this same territory was a dry hole, both of these items have been taken into consideration by the War Production Board in an effort they are now making to solve the fuel shortage in the Appalachian area and I am informed by staff members of the War Production Board and it has also been indicated to me by a staff member of the Federal Power Commission, that they have collaborated on these ideas.

Q. Have you understood there has been any written memorandum issued?

[fol. 10572] Mr. Littman: By whom to whom, Mr. Culton:

By Mr. Culton:

Q. By anyone to anyone, between those two Boards.

A. I have understood that one was in the process of preparation by the staff of the Federal Power Commission or certain members of it which will contain their ideas as to the solution of the fuel shortage in the Appalachian territory.

Q. Under these circumstances which you have related, do you think it is possible to look into the future and determine what Panhandle Eastern's operating problems will be over the next year or two such as would be possible under ordinary circumstances?

A. The only crystal gazing that I am willing to indulge in at this time is that Panhandle Eastern Pipe Line Company is going to be one of the favored few, from the standpoint of making a real contribution in the matter of fuel for war industries and that the book of rules is going to be written by the War Production Board.

Q. And do you expect to try to follow that book of rules?

A. I expect to not only try to follow it but to try to cooperate in every way so long as I am satisfied that Panhandle Eastern is not being singled out as the one company to make sacrifices at the expense of others.

[fol. 10573] Recross-Examination

By Mr. Goodman:

Q. Will you recapitulate, for the sake of convenient reference at this point, the principal regulated markets of your company?

A. All of the markets that we serve except those which we serve to direct sales.

Q. Well now, what are the most important ones? First, there is Detroit—

A. (Interposing) No, fist there is Detroit.

First, there are the markets in Kansas which are small, insignificant. Then there are the markets in Missouri

some of which are quite important, principally direct industrial sales in the State of Missouri and principally they are those to brick plants.

Then we come to the State of Illinois in which we serve various territories including Springfield, Peoria, Decatur and others. Then we come to the State of Indiana in which we serve the various communities in the northwestern part of the State with the exception, possibly, of South Bend, including Fort Wayne and going on down as far south as Muncie. Then we come into Ohio and serve some small communities.

Then we finally, at the end of our line, serve Detroit.

* * * * * * * *

[fol. 10574] Q. Mr. Creveling, in Kansas, your regulated markets, you say, are insignificant?

A. That is right.

Q. Now, in Missouri, how significant are they?

A. Very important.

Q. Important, what are the major—

A. (Interposing) The records will show that. I do not have that in mind.

Q. Can you name any city in Missouri?

A. I do not carry in my mind the exact communities that we serve. I do not try to.

Q. I do not mean it that way. You say that the regulated markets in Missouri are very important.

A. I said the markets in Missouri are important.

Q. Well, limit it to the regulated markets. Are they a significant factor?

A. Yes, there are some there, Jefferson City is an [fol. 10575] important market. At least, the Missourians think so.

Q. That is the most important community in Missouri that you serve?

A. That is the most important one in Missouri, yes.

Q. Now, you serve Springfield and Decatur, you mentioned?

A. That is correct.

Q. And then you serve, did you say, northeastern Indiana or northwestern Indiana?

A. Well, we serve, if you will look at our map, you will see very definitely in connection with that map what we serve. Our line crosses near Terre Haute and we serve Muncie, Anderson, Richmond, Fort Wayne and Crawfordsville, Logansport, La Fayette, and other way stations.

Q. Now, in your opinion, Mr. Creveling, would you be able to say whether or not this rather large system is more advantageous to the separate communities that you serve than would be smaller companies adapted to serve their individual requirements?

A. You would have to write more in your book of rules before I can answer that. I would have to know where the source of supply was.

Q. Well, your company.

A. You asked me to as to this company compared with a lot of individual small companies?

[fol. 10576] Q. Yes, having the same source of supply.

A. I do not think I quite understand your question but, if I do, I do not see that the communities would care whether the gas came through a large pipe line or through a small one if it came from the same source of supply and the cost to them was the same.

Q. Yes. Does your organization, with the kind of pipe line you have and the markets you have, result in any great economy to the customers along the line, that is, the principal or major regulated customers, than would be the case if these principal customers were served by individual concerns from your source of supply?

A. There is no customer that we serve indirectly that theoretically is not benefited by the fact that we serve others.

Q. So that it is your opinion, I take it, that the fact that you have a large market of Detroit is a benefit to customers along your line?

A. Just as the fact we have customers along our line is of benefit to Detroit.

Q. Yes. Now, Mr. Creveling, when you speak of that as a benefit, you mean that everybody along the line, through his demand, makes some contribution toward a mode of rendering service which is more economical than would be the case if those customers, in substantial [fol. 10577] amount, were not on the line. Is that right?

A. My answer to your surmise is that every individual customer can be served economically at a lower rate than each one could be individually.

Q. Yes. Would that be true if customers were grouped in some way? Naturally, you do not have in mind, do you, a separate concern to serve each individual customer?

A. No, you suggested that in one of your questions.

Q. You would have in mind a reasonable grouping of territory?

A. Most certainly, yes.

Q. But your pipe line and your business, taken as a whole, in your judgment is the most economical means of serving those customers, is that right, that you know of?

A. If I knew of any more economical way to serve with natural gas, I certainly would try to do it.

Q. Well, suppose that Detroit were eliminated?

A. Yes.

Q. From the line and ceased to be a customer.

A. As of today?

Q. As of today. Would your system then be as economic with respect to the remaining customers as it is with Detroit on the line?

A. It is my judgment that our system would be as economic if Detroit were cut off today as if it were not.

[f5l.10578] Q. It would?

A. Yes. We can get other markets today.

Q. Well, you mean that you would have some other market in substitution? A. Certainly.

Q. But you still would have a system of the same size serving the same amount of gas and you would still have the situation that it is the volume of demand that makes your system the most economic compared with a smaller system. Is that right?

A. That is right.

Recross-Examination

By Mr. Chamberlain:

Q. What has been the increase in sales for the first three months of this year as compared with the first three months of last year?

A. I do not know. The record, I believe, will show that.
[fol. 10579] Q. Do you know whether those facts have been furnished for the record, Mr. Creveling?

A. It is my judgment that they have. It is my remembrance that they have. If they have not, they are easily obtainable.

Mr. Littman: Do you gentlemen on the other side of the table know?

Mr. Culton: I do not think that exhibit was brought up to date—yes, it was, wasn't it?

Mr. Littman: To February 28, 1942?

Mr. Culton: My recollection is you requested that that be continued to date and that—

Mr. Littman: (Interposing) Not I.

Mr. Culton: If you did not, of course, we can do as we have always done.

The Witness: As a matter of fact, for the first three months of this year we probably would not have a complete record of yet. That usually runs to around the 20th, the 22nd of the month before our previous records are completed so you probably do not have in this record the first three months of this year. You have two months.

Mr. Littman: We have exhibits which reflect the result of two months' operation.

The Witness: That is right.

Mr. Littman: But I do not believe we have any comparison, for instance, of the sales in January,
[fol. 10580] 1941, as compared with the sales in January of 1942 and the same with February. We do not have that, so far as I know.

Mr. Wheat: Of course one month, Mr. Littman, would not be significant, just one month standing alone.

Mr. Chamberlain: No, but three months are quite significant.

Mr. Littman: I was speaking of a series of months.

Mr. Wheat: I understand.

The Witness: Mr. Chamberlain, I want to be constructive in helping you arrive at whatever point you wish. If you have in mind the development of the fact, if it is a fact, that we have sold more gas the first part of 1942 than we did in 1941, I can say, without recalling the exact figure, that we have.

Mr. Littman: Substantially more, Mr. Creveling?

The Witness: As I recall, it is not a lot more but some more but those are facts that can very easily be developed and there is no reason for any conjecture on that.

Mr. Littman: Do you know whether the increase has been due to weather conditions or due to increased volume of sales?

The Witness: Our increase, as I recall it, has been due primarily to the gradual growth of our industrial requirements.

[fol. 10581] Mr. Littman: That is a continuous growth?

The Witness: Which started last year.

By Mr. Chamberlain:

Q. Mr. Creveling, did you have brought up to the close of March such exhibits as have been offered here which would show the increase in sales, that is, in quantity as well as revenues?

A. Is March 31 the closing date of these records?

Trial Examiner: There has been no date set.

Mr. Culton: We will be glad to prepare those exhibits but, of course, the question of time comes in again.

The Witness: The item of time comes in and I am quite certain that we are just now getting to a point in our accounting where the records for March will first become available.

Mr. Chamberlain: I think that is right but this is the 21st.

The Witness: That is right. I think just now they have become available.

[fol. 10582] Mr. Pittman: Yes, Mr. Wheat, it reminds me a little bit of some of your exhibits, starting with Exhibit No. 223, et seq., that give us the alleged increases in expenses and the capital additions but do not tell us any [fol. 10583] thing about the revenue.

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The Witness: Mr. Chamberlain, what you would like to have, as I understand it, is pertinent statistical data on our business for the first three months of this year compared with the first three months of last year. Is that right?

Mr. Chamberlain: That is right.

The Witness: We will be very glad to have that prepared at once.

Mr. Chamberlain: And that will break down your sales so we will know which type is improving and which is going down.

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The Witness: We shall be very glad to furnish promptly that information for the first three months of this year compared to the first three months of last year on the basis that we usually carry it.

By Mr. Chamberlain:

Q. Now, may I ask when the contract with the Hercules Powder Company comes on your lines?

[fol. 10584] A. You mean the one near Louisiana, Missouri?

Q. Yes.

A. Whenever the plant is completed.

Q. And when is that presumed to be?

A. The last date that I have heard is about August 1.

Q. Have you made any other recent contracts for the sale of industrial gas for defense purposes?

A. We have been approached by several other industries, the largest one of which was one requiring 35 million cubic feet of gas per day for a defense industry being built about nine miles east of Lawrence, Kansas.

We have, in all cases, said to those industries approaching us, "You first make your peace with the War Production Board as to the fuel you may use and then come back to us". Some of those small ones have done that. I have in mind, as an example of that, the Bohn Aluminum Company at or near Adrian, Michigan, which started out with a requirement of 200,000 cubic feet per day and the last advice I had it is now increased to 1,200,000 cubic feet per day and I was informed yesterday that the request for that additional amount of gas probably would be approved by the W.P.B.

Q. Are there others of that nature at the present time?

A. Yes, there are others of that nature. Mr. Batten of the Michigan Consolidated Gas Company, within the [fol. 10585] past week or ten days, has told me that the demands on the system of the Michigan Consolidated Gas Company for industrial gas were increasing very greatly and we were trying to see what we could do, he and I, in order to balance out the gas we might make available for Michigan Consolidated with the predicted increase in requirements of the Detroit area for this coming winter which, as I recall it, he estimated at about 170 million feet per day of which, to be safe, he was of the opinion we should be in position to deliver 140 million.

Q. And was a contract recently entered into there with the Monsanto Chemical Company?

A. That name almost registers.

Q. Do you know about that company near Trenton?

A. No, that has not been consummated, I recall now. It is the one that Mr. Batten and Mr. Neuner were talking about. It required a line from our main line. It is down near the Trenton Channel Plant of the Detroit Edison Company. That has not yet been consummated.

[fol. 10586] Recross-Examination

By Mr. Littman:

Q. Mr. Creveling, one of the first matters which you discussed in your direct examination was the matter of the curtailment of sales to industries during the past winter, that is, the 1941-1942 winter.

Did I correctly understand you to say that you were, in fact, compelled to curtail and even wholly interrupt sales to certain industries during the 1941-1942 winter?

A. We did.

Q. And that your curtailment included not only your so-called indirect sales which are made through other utilities but also direct sales, did it not?

A. That is correct.

Q. Is it a fact that, in previous winters, you have also curtailed direct industrials? A. Yes.

Q. To a larger or to a lesser extent than was true this past winter?

A. The direct sales, I would say, might possibly have been to substantially the same extent although I am not certain but the total curtailment was greater this winter than it has been in previous winters.

[fol. 10587] Does that answer your question?

Q. Yes.

A. The reason I answer it that way is this: We have certain direct industrial sales which are really, in effect, not on the line or are off during the months of January and February. Two of those are large sales, one of them is the cement plant near Quincy, Illinois, and the other is the powerhouse near Jefferson, Missouri. They have been completely cut off on previous winters.

Q. We would not call that a curtailment, would we?

A. That is a complete interruption. Outside of those two which would be the same, I would say, otherwise, the curtailment was greater this year than previous winters.

Q. And the curtailment has been successively greater over the past five winters, hasn't it? That is to say, in the winter of 1940-1941, the curtailment was less than this past winter?

A. I do not believe a study of the records would show that. It would show that the 1941-1942 curtailment was greater than 1940-1941, but, going back of that, I do not believe you would get a gradually ascending curve of curtailment.

Q. Is it a fact that you curtailed more of the industrial sales, that is, the direct industrial sales this past winter than ever before?

[fol. 10588] A. It is my judgment that there was one other time that we curtailed direct industrial sales to practically the same extent that we did this past winter. I say that because I recall that we cut off the cement plant, the powerhouse load, and we cut the Keystone Steel & Wire down materially, on one other occasion.

Q. What year was that?

A. I do not recall but probably 1937-1938.

Q. That is the winter of 1937-1938, approximately?

A. Yes that may be off a year but we did make such a curtailment and it is my judgment that would substantially equal the curtailment of industrials this last year.

Q. You have used the term, I believe, "compelled" in describing the fact that you were forced to curtail your direct industrial sales as well as the other direct industrial sales. Does the use of that term by you imply, as I believe it does, a regret on your part that you had to curtail?

A. It implies a recognition of an obligation on our part to first serve those customers whose health and comfort depend on the gas.

Q. Mr. Creveling, in discussing certain exhibits that were offered by Mr. Burnham and by Mr. Hinton, to-wit, Exhibits Nos. 223 to 231, inclusive, you did not mention anything, as I recall it, about the load factors which are [fol. 10589] mentioned in certain of Mr. Hinton's exhibits.

For instance, in Mr. Hinton's Exhibit No. 225, he shows the estimate of operation and maintenance costs south and west of Liberal compressor station on the basis of the 307,000 M.c.f. continuous daily sales capacity with an operation at 70 per cent capacity factor.

Also, in Exhibit No. 226, he uses the same 307,000 M.c.f. figure but reflects the figures on the basis of a 90 per cent capacity factor.

In Exhibit No. 227 presented by Mr. Hinton, he uses a 70 per cent load factor called by him capacity factor in connection with 338,000 M.c.f. and, in Exhibit No. 228, he shows similar figures based upon 338,000 M.c.f. continuous daily sales capacity as a 90 per cent load factor.

A. Might I say that those are all capacity factors.

Q. Very well, I think the record shows what they are and you correct me if I should read the wrong term in referring to those figures. A. Yes.

Q. Now, did you instruct Mr. Hinton to use those two capacity factors? A. I did.

Q. Why?

A. Because the 70 per cent capacity factor is pretty close to what our normal operations have been.

[fol. 10590] Q. Now, let's stop there and say that that is close certainly to what it has been for the full year 1941.

A. That is right. On the basis of conversations that have been had with those working on the fuel problem in connection with war industries, it was my judgment and is now my judgment that we are going to be called upon to operate Panhandle Eastern Pipe Line Company facilities during the next year and possibly longer on a 90 per cent load factor.

Q. Now, may I correct you—

A. (Interposing) Capacity factor.

Q. You mean capacity factor?

A. Yes, capacity factor.

Mr. Culton: Suppose you explain the difference between load factor and capacity factor.

The Witness: A pipe line might have 100 million of maximum capacity and if it operated, handled one million cubic feet of gas per day, the load factor would be 100 per cent, when the capacity factor would be one per cent.

By Mr. Littman:

Q. Now, in your previous answer, you used the term "next year". Were you referring to 1942 or 1943?

A. I do not know in what connection I used that.

Q. Let me refresh your recollection. You were talking about the 90 per cent capacity factor.

[fol. 10591] A. I mean the first year that the War Production Board has placed upon us this load that we are talking about, whether that starts in July or June or August, it is the first twelve months thereafter.

Q. You expect the 90 per cent capacity factor to come into play sometime this summer?

A. I should say if we are in a position to make a contribution in the matter of fuel for war industries, it should come into play this summer.

Q. ~~What will be the character of the added load which~~ will bring about this capacity factor?

A. That I do not know. No longer ago than yesterday, it was indicated to me that there was a probability that we would be called upon to deliver 10 million feet of gas during the present off-peak period, that is, from now on until the period of peak demand again, to go into pipelines east of the territory usually served by us, a part of which might go into storage for winter use and a part of it might supplant gas now being furnished from gas wells which would be closed in and allowed to rock up in order that they might be able to produce more gas during periods of peak demands.

Q. Would that 10 million load that you just referred to be an everyday affair except for peak days?

A. As a practical matter, it probably would work out [fol. 10592] that in the summer time we would put in varying amounts that we could from day to day, putting the maximum amount every day into storage or into other uses and, on the peak days, we would supply whatever we could above the requirements of our so-called essential market which could not be curtailed.

Q. Is that the only sale you know of?

A. I do not understand that question.

Q. Is that the only prospective sale you have in mind or do you have others?

A. That is not one that we have in mind. That is one we are told about.

Q. Do you have any others? A. Yes, sir.

Q. That fall in that category?

A. That fall in the category of supplying fuel for war industries?

Q. Yes.

A. We have. We have the one that Mr. Chamberlain mentioned.

Q. The Hercules Powder Company?

A. That will come on along the first of August, near Louisiana, Missouri. That starts out with a contract of

about 8 million a day and, in recent conversation with Mr. Batten, he indicates many industries in the Detroit area [fol. 10593] are importuning him for gas.

Q. ~~Pardon me, before you continue,~~ the Hercules Powder Company contract will be a firm contract?

A. It will be an interruptible sale, the same as our other interruptible sales.

[fol. 10594] Q. Will it be a direct sale?

A. It will be a direct sale..

Q. Very well. Now, you may continue with your list of companies.

A. Yesterday at the office of the War Production Board I was shown a stack of applications from industries in the areas served by our pipe line through distribution companies asking for the right to use gas as a fuel.

I do not recall those all, but since I had some conversations with one of them at Adrian I do recall that.

That is the Bohn Aluminum and Brass Company, which started out with 200,000 per day and is now built up to 1,200,000 per day.

In addition to that, as I previously testified today, we have been asked, as to industry, to supply upwards of 35 million a day for some war defense plant that is going to be built about nine miles east of Lawrence, Kansas.

We are constantly being asked by distributors to whom we sell gas wholesale how much additional gas will be available for their industries.

Q. Well, the gas business looks pretty good, doesn't it, for the future?

A. If you interpret "good" as meaning large volume regardless of the net returns therefor, yes.

[fol. 10595] Q. Well, your inability to answer the question as to return is merely a reflection of your inability to presently estimate the revenue: isn't that right?

A. Both exact volume and revenue. It is my judgment that we are going to be called upon, within the next year, to furnish every cubic foot of gas to someone, that we can possibly get through our lines, and I think, if we are called on, we should make that contribution.

Q. You are going to do your very best?

A. Absolutely, yes.

Q. To meet the demand? A. That is right.

Q. Now, is a 90 percent capacity factor approximately the highest workable capacity factor that could be put into effect on your system, from a practical viewpoint?

A. The highest known one that a long distance transmission pipe line has been operated is between 93 and 95, which is the Natural Gas Pipe Line Company of America.

I would say that, because of the wider diversity of our load—their entire market, as I understand it, is at Joliet, where they sell to another pipe line company which distributes it in the Chicago area.

I would say that we could hardly hope to maintain quite as high a capacity factor as is maintained by the Chicago Pipe Line Company. I think 90 is a reasonable estimate.

[fol. 10596] If it can be 92, why, we want to make it 92.

Q. In order to operate the system at the 90 percent capacity factor is it your expectation that it will be necessary to install and operate the standby compressor engines shown by Mr. Burnham in his exhibit—

Mr. Culton (Interposing): It is in all three of Mr. Burnham's exhibits.

Mr. Littman: Yes, it is in all three. They are all about the same.

A. Because of the fact that we are already engaged in making out seasonal overhauls of compressing equipment, it is my judgment that we will not be taking an unusual chance in going through the next winter season without any spare equipment.

By Mr. Littman:

Q. You mean through the 1942-1943 winter?

A. That is correct. But by the spring of 1943 it is my judgment that, if we are operating at better than an 80 percent load factor, and are going to be asked to continue to operate on a high capacity factor, we must as a matter of being in a position to render reasonable service, have sufficient spare equipment so that we can conduct continual overhauls.

Mr. Culton: Does that mean an extra unit in each station?

[fol. 10597] The Witness: That means an extra unit in each one of our compressor stations.

By Mr. Littman:

Q. As described by Mr. Burnham in each of his exhibits—to wit, Exhibits 229 to 231 inclusive? Page 5 in each exhibit?

A. It might be interesting to you, in passing, to know that the Chicago Pipe Line Company, because it was apparent that their capacity factor would be high, from the beginning, in the original installation installed sufficient compressor capacity to have one spare unit in each station, and they have continued to maintain that position.

Q. Now, Mr. Creveling, do you expect that there will be one idle engine at each compressor station on the peak day?

A. Yes, sir.

Q. If they were installed?

A. Yes, sir. There will be one engine that will be down being overhauled, theoretically, every day in the year.

Q. Has that been the practice of other companies, if you know?

A. Substantially so, yes, operating at capacity factors approaching 90 percent.

Q. I see. Now, referring to Mr. Hinton's exhibit No. 224, he has estimated capital expenditures south and west of Liberal compressor station required to meet peak day [fol. 10598] sales of 338,000 M. c. f.

Now, on a 90 percent load factor, according to Mr. Hinton's testimony, that will amount to annual sales of 110,512,512 M. c. f. sales on the basis of the sale measurement?

A. That is right.

Q. Now, is that the annual load which you shortly expect to be required to carry and sell?

A. I expect, for the first year, first year of operation, after conditions indicated by the War Production Board become operative, that we shall deliver for market in excess of a hundred billion cubic feet.

I would say, therefore, that the 110 billion is a realistic figure.

Mr. Wheat: Did you say a hundred million cubic feet, Mr. Creveling?

The Witness: Billion.

Mr. Wheat: A hundred billion?

The Witness: Yes, sir.

Mr. Wheat: That is an annual figure, then?

The Witness: That is right.

By Mr. Littman:

Q. Then you fully expect the start of that to come sometime this summer—the summer of 1942?

A. That is my judgment, yes.

[fol. 10599] Q. Now, you are unable, as you have testified, to state which of the various alternatives will be adopted by the Panhandle Eastern System with respect to installation of capital additions to meet this load?

You can't state definitely at this writing what method will be used, can you?

A. Which one of three [three] we will be permitted to pursue: is that your question?

Q. That is right.

A. It is my very definite judgment, although it is only a judgment figure, that the first one requiring the approximate 60,000 tons of steel for pipe is out, although normally that is the one we should do.

Q. That is the one you would like to do?

A. That is correct.

Q. And that one, as we have already agreed, is the one that is contained in Exhibit No. 230?

A. That is right.

Q. Presented by Mr. Burnham?

A. That is correct.

Q. Now, in view of the present uncertainty as to which of the alternatives of capital installations will be adopted, I take it that the Board of Directors of Panhandle Eastern Pipe Line Company has not as yet acted upon or approved any of these methods here submitted.

[fol. 10600] A. That is correct.

However, I should be greatly surprised, especially in view of the fact that the past action of our Board of Directors, if they should not make every effort to make whatever contribution seems essential, from a standpoint of furnishing additional fuel to war industries.

Q. And the decision in that regard, of course, will largely depend upon what the War Production Board thinks and orders?

A. Putting it another way, which one of these two propositions I shall recommend to my board for approval depends on the final conclusion of the War Production Board as to which one they feel that they will be able to assist us in obtaining material for.

Q. Is there any question about your being able to get the approximately 30,000 tons of pipe and the additional compressor units required to put into effect Mr. Burnham's plan of capital additions for the main line, which is included in Exhibit No. 231?

A. My judgment, from recent conferences with representatives of the War Production Board is that that is a realizable project for this summer.

Mr. Culton: That basis is the 338,000,000 on the less economic basis, isn't it, Mr. Creveling?

The Witness: That is correct. It is the one involving [fol. 10601] substantially 30,000 tons of steel and compressors in the same study.

By Mr. Littman:

Q. Mr. Creveling, in your direct examination you made some mention of the possibility of being required to make an interconnection with other utilities, the interconnection to be at the intersection of the Ohio-Indiana state line or thereabouts, said gas to be carried to the market around Pittsburgh to relieve shortage.

In that connection, is there any doubt in your mind that the Federal Power Commission will have jurisdiction over the price at which you will sell that gas to other utilities?

A. Among other things—many other things—I am not an attorney. I do not wish to express a legal conclusion.

Q. Well, such a sale would be a resale to another utility, wouldn't it?

A. That is correct.

Mr. Wheat: Do you mean a sale for resale?

Mr. Littman: That is what I meant to say.

By Mr. Littman:

Q. It would be a sale to another utility for resale, wouldn't it?

A. That is right. Just as the sale to us at some other point where some other pipe line might cross us would be a sale to us for resale, which is also within the realm of [fol. 10602] Order L-31.

Q. Well, it is not your idea that Order No. L-31 of the War Production Board prescribes any prices at which gas shall be sold; if you have such a paragraph in mind I wish you would point it out to me.

A. Very unfortunately, there is no indication that, from our standpoint, it will be sold at a profit. What I meant, Mr. Littman is this: that in L-31 there is a provision for interconnection of main transmission systems.

We might be required—or, putting it a litttle differently, the Chicago Pipe Line Company or the Northern Natural Gas Company might be required to deliver gas to some place where their line crosses ours, which we might carry hundreds of miles, and deliver to some other utility.

L-31 is silent on the price at both ends, which is a little confusing to us.

Q. Well, if the Federal Power Commission has jurisdiction over the price, then of course we will set the price presumably on a reasonable basis; there is no doubt about that in your mind, is there?

A. Without saying Yes or No to that, I am not certain what the emergency power of the War Production board is.

Q. Now, Mr. Biddison has made a study of allocation, which is reflected in Exhibit No. 251.

According to Exhibit 251, and according to Mr. Biddison's testimony, it appears, as an upshot of that allocation, [fol. 10603] that your compnay is earning something like

—or something in excess of—one hundred percent on its property allocated to that direct industrial business. Does that comport with—

A. (Interposing) I hope my board of directors has their attention called to that.

Q. Well, does that one hundred per cent profit comport with your idea of the actual earnings that you are making on that portion of your property devoted and allocated to direct industrial sales?

A. I think Mr. Biddison's allocation is as fair and exact an allocation as can be made on the basis of a fair interpretation of Order No. 71.

Mr. Culton: 73.

The Witness: 73. That is the Colorado Interstate case.

By Mr. Littman:

Q. You mean the opinion?

A. The opinion. Well, we are beginning to think of these opinions as orders.

Mr. Littman: Well, they have orders that are issued in connection therewith.

The Witness: That is right.

Trial Examiner: That is a good attitude, Mr. Creveling.

The Witness: We hope that we shall not have to change it.

[fol. 10604] A. I think I know what you have in mind, Mr. Littman, and I might say to you frankly that I think that is a crazy idea.

By Mr. Littman:

Q. What is a crazy idea: Mr. Biddison's allocation or what?

A. No. The idea of taking two classes of business and trying to divide, as is tried in this proration.

I can't see how it is possible to not recognize both classes of business, when each business contributes something to the other.

Now, unfortunately that isn't apparently the position that some members of this Commission had in mind, but nevertheless it is my opinion.

I think each one contributes something to the other, and that should be recognized.

I have only been in the gas business since 1904, and up until recently we have always considered that to be the case.

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By Mr. Goodman:

Q. In your business, Mr. Creveling, do you make use of any allocation between regulated and nonregulated business—that is, allocation of jointly-used assets—in determining what you will charge your nonregulated customer? [fol. 10605] A. It may be heresy to say so but we try to charge our nonregulated customers all the traffic will bear.

Mr. Littman: You are in competition with other fuels there?

The Witness: We are in competition with other fuels, direct competition with other fuels, such as coal and oil.

Mr. Goodman: You answer the question that I asked you "No": is that right?

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A. I think the answer to that is No, Mr. Goodman.

By Mr. Goodman:

Q. You charge what you can get?

A. That is correct. So long as we do not discriminate between users in the same class of business.

Q. And so long as it gives you something above your out-of-pocket cost?

A. That is correct.

The Witness: Is that good business?

Mr. Goodman: In my opinion it is.

By Mr. Littman:

Q. In other words, in your opinion your company is not earning any such profit—

[fol. 10606] A. (Interposing) That is correct.

Q. (Continuing)—as one hundred percent on its unregulated business?

A. That is correct.
Q. And if you are filling out a questionnaire for any governmental agency, such as the War Production Board, or in response to any inquiries by the Truman Committee, you wouldn't say, would you, that you were earning anything like a hundred per cent on your direct industrial—
A. (Interposing) My answer would be: I do not know.
Q. And that is because you operate your business as one unit?
A. That is correct.
Q. I take it, from your responses here, that you consider these allocations as a somewhat unrealistic thing?
A. Your observation is correct.

Mr. Culton: You didn't mean that Mr. Biddison's attempt to allocate in accordance with the views of the Power Commission in the Colorado case was unrealistic?

The Witness: No. I simply mean that this was an unrealistic set-up.

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[fol. 10607] Mr. Culton: That is, any attempt to allocate return, as between regulated business and unregulated business: is that what you meant was unrealistsic?

The Witness: That is correct.

Mr. Littman: Well, you mean Mr. Biddison's entire theory?

The Witness: Mr. Biddison's theory was fine. If you are going to allocate it theoretically you should allocate it on the basis of the investment and the expenses incident to each part of the business.

By Mr. Littman:
Q. But it is theoretical?
A. That is correct.
Q. And not practical?
A. That is what I am trying to say.

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[fol. 10613] (The documents referred to were received in evidence as Exhibits Nos. 223 through 231.)

Mr. Littman: Now we take up Exhibit 249, which was presented by witness Watkins, entitled, "Pro Forma Consolidated Income Account for the year ended December 31, 1941, as Adjusted to Give Effect to Federal Income and Federal Excess Profits Tax Rates Proposed in Recommendation of Secretary of Treasury Morgenthau on March 3, 1942, Before House Ways and Means Committee."

We object to this exhibit simply because these proposed tax rates are, as the evidence clearly shows, not in effect, and the exhibit deals wholly with a hypothetical problem.

* * * * *

[fol. 10615] (The document referred to was received in evidence as Exhibit No. 249.)

Mr. Littman: We have an objection to Exhibit No. 250, entitled, "Panhandle Eastern Pipe Line Company and Subsidiary Companies, Statement of Rate Case Expenses in Connection with Federal Power Commission Consolidated Dockets G-200 and G-207, including actual cost to February 28, 1942, and estimated cost to complete."

* * * * *

[fol. 10617] (The document referred to was received in evidence as Exhibit No. 250.)

Mr. Littman: Mr. Culton, is my understanding correct that that takes us through from 223 to the end?

Mr. Wheat: Now there is 232 to 248 inclusive.

Mr. Culton: I understood that all of them were admitted except the ones that counsel specifically mentioned. He said he had no objection to the others.

Mr. Littman: I have no objection to any others in the series to which you alluded, Mr. Culton.

Trial Examiner: That commences with 233 and extends through—

Mr. Littman: No; 223.

Trial Examiner: Those have been received. The series from 223 to 231 have been received.

[fol. 10618] Mr. Culton: 232 to 248, there are no objections, and I assume they will be received.

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(The documents referred to were received in evidence as Exhibits Nos. 233 to 248 inclusive.)

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Mr. Wheat: You have received 249 and 250, and, I think, 251 is now without objection.

Trial Examiner: No objection, Mr. Littman, to Exhibit No. 251?

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[fol. 10619] (The document referred to was received in evidence as Exhibit No. 251.)

Mr. Wheat: Now, Mr. Examiner, 253 and 254 have been received.

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Trial Examiner: 252 was received on the 15th.

* * * * * * * *

Trial Examiner: 255 and 256 have been received today and 257 has not.

Mr. Littman: 257 has been reserved for a response by Mr. Watkins to one of my requests.

Trial Examiner: I failed to take the designation for that. Will you give it to me, if you can, someone? Well, never mind.

* * * * * * * *

[fol. 10620] Mr. Littman: Mr. Examiner, I think perhaps I can facilitate matters that will bring us up to Exhibit No. 223.

Now, with respect to all of the exhibits from No. 170 through Exhibit 217 we have objection to only one exhibit in that series.

Mr. Wheat: Well, Mr. Littman, those exhibits 170 to 195 are already admitted.

* * * * * * * *

Mr. Wheat: Now, then, 196 has not yet been admitted, and 198 has not, but then there are a number of hiatuses. That is why I thought your general statement might not be as clear—

Trial Examiner (Interposing): They were received up to 196, and 196, 198, 199—

Mr. Wheat (interposing): 202, 206, 207, 208 and 210 to 217 inclusive, are offered but not yet received.

Trial Examiner: That accords with my record.

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[fol. 10621] Mr. Littman: Then all I need to say about these exhibits is that we have objection to Exhibit 196, which deals with an adjustment giving effect to Secretary of Treasury Morgenthau's proposed tax laws?

Trial Examiner: That is a consolidated income statement?

Mr. Wheat: That is a pro forma consolidated income account for the year ended December 31, 1941.

* * * * * * * *

(The document referred to was received in evidence as Exhibit No. 196.)

Mr. Littman: We have no objection to any exhibits subsequent to Exhibit 196, other than those we have already mentioned.

Trial Examiner: 198, 199 will be received.

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Mr. Littman: Pardon me. May we have an objection to Exhibit 199—I am sorry—which also reflects the proposed tax law recommended by Mr. Morgenthau. I take it you will make the same ruling.

* * * * * * * *

[fol. 10622] (The document referred to was received in evidence as Exhibit No. 199.)

Trial Examiner: The exhibits numbered 210 to 217, both inclusive, will be received.

(The documents referred to were received in evidence as Exhibits 210 through 217.)

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Mr. Wheat: Was 202 ~~received, Mr. Examiner?~~

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(The document referred to was received in evidence as Exhibit No. 202.)

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Trial Examiner: Just a moment. We are up to 206, 207, and 208.

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[fol. 10626] Trial Examiner: The Trial Examiner will rely upon the privilege granted by the rule and will direct that [an] single copy of this exhibit be included in the original file of the Commission and that no other copies be made. This is in view of the statements of counsel, and with that condition, Exhibits 206, 207, and 208 will be received.

(The documents referred to were received in evidence as Exhibits 206, 207, and 208.)

Mr. Wheat: Mr. Examiner, with that understanding, may I turn now to some prior exhibits which I believe really have been left out of the formal admission by inadvertence? I refer, first, to Exhibits 19 to 31, inclusive, offered by Witness Smith. Those were identified back on pages 423 and 422 of the transcript.

[fol. 10627] Trial Examiner: These were not omitted by advertence, but we have through the record assumed they have not yet been ruled upon.

* * * * * * * *

[fol. 10631] Trial Examiner: The Trial Examiner is aware that there will be at some future time further proceedings in connection with this matter, and in view of the possibility that there may be such future proceedings and further hearings in this proceeding, the exhibits to which objection is made will be included, and all from 19 through 36 will be received.

(The documents referred to were received in evidence as Exhibits 19 to 36, inclusive.)

* * * * * * * * * *

[fol. 10632] Mr. Wheat: It is understood, Mr. Examiner, is it not, that Exhibits 42 to 46, inclusive, have been received in evidence?

Trial Examiner: The interruption was more serious than I supposed, and those exhibits will now again be received.

Mr. Littman: I think they should be so handled at this point, because the official reporter's index of that day's—or, table of contents—of that day's hearing did not carry those exhibits as having been admitted, and so perhaps it might be well to have it admitted here.

(The documents referred to were received in evidence as Exhibits 42 to 46, inclusive.)

Mr. Wheat: Now, Mr. Examiner, the next exhibit that my present record shows not to have been admitted is [fol. 10633] No. 61 of the Witness Friday.

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Mr. Wheat: Mr. Littman, that is correct, everything up to 61 is admitted, from 47 down to 61. They are all in, as my record shows.

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(The document referred to was received in evidence as Exhibit No. 61.)

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[fol. 10635] Mr. Wheat: Now, then, we come to Exhibit 73 of Witness Watkins, which by some inadvertence, I did not offer when I was offering Exhibit 72 the other day.

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(The document referred to was received in evidence as Exhibit No. 73.)

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[fol. 10636] Trial Examiner: 73 and 74 and 76. If there is error in the Trial Examiner's record and they have not been received, they will now be received.

(The documents referred to were received in evidence as Exhibits 73, 74, and 76.)

Mr. Wheat: What about 75?

Trial Examiner: 75, Mr. Littman suggests he wishes to discuss.

Mr. Littman: Mr. Examiner, there are certain objectionable parts of Exhibit No. 75. I think I shall attack this exhibit by way of a motion to strike. I shall direct my motion to strike against those portions of Exhibit No. 75 which deal with reproduction cost sometimes called market value of lease. Here this market value is expressed as of February 1, 1937, which date is pretty much passe, so far as our immediate interests are concerned. I move to strike that part of page 16 which commences with the first paragraph: "The value of gas at the well" and so forth, down to the end of that page; I move to strike page No. 17, and the first full paragraph on page 18, and the last full paragraph on page 18. I also move to strike page 20, page 21, page 22, and page 32 of Exhibit No. 75.

Your Honor will recall that you have heretofore sus- [fol. 10637] tained our objection to a similar exhibit which was offered by Mr. Wallace dealing with this same subject, to wit, market value, so-called, of natural gas leaseholds.

* * * * * * * *

Mr. Culton: No, sir, we don't care to be heard, Mr. Examiner, except to point out that this deals with real estate, and irrespective of whether or not it is the only value which is to be taken into consideration, our contention is that it is evidence of the fair value which we have a right to have considered by the Commission.

Trial Examiner: You do present it as evidence of some value not recorded on the books of the company?

Mr. Culton: That is right.

Trial Examiner: And the exhibit, as a whole, is addressed to that purpose?

Mr. Littman: No, your Honor.

Mr. Culton: No: just certain portions of it, Mr. Examiner.

Trial Examiner: I mean these portions that are objected to.

Mr. Culton: Those portions of it are a part of the report which Mr. Davis made in February, 1937. We of- [fol. 10638] fered his entire report. That report dealt both with his prediction of the amount of gas which might be produced and also with the value of the reserves.

As I understand it, the objection is made to that portion which deals with the value of the reserves.

We say that that evidence is pertinent evidence proffered for the consideration of the Commission along with all other evidence in the case in arriving at the present value.

Now, obviously, if the only value which can be considered by the Commission is the original cost as reflected on the books, this does not purport to be that original cost, but we do not so understand any decision.

Therefore, we think that this evidence is admissible.

Mr. Littman: By the way, I might state again, your Honor, that aside from our very strenuous legal objection to any evidence of fair value of reserves, that this exhibit speaks as of February 1, 1937, which seems to be pretty much out of date and which was, of course, superseded if ever anything was superseded, by Mr. Wallace's treatment of this same subject, which your Honor has already ruled to be admissible.

Now, even if fair value were admissible, in this case, of what use would fair value, as of February 1, 1937, be to us here today? I submit, none whatever.

[fol. 10639] Mr. Wheat: Mr. Examiner, the next one that I have on my list may have been handled. I may be wrong in this. It is Exhibit 93, and along with that are Exhibits 96 and 97, which were offered by counsel for Michigan Gas Transmission Corporation.

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Mr. Littman: Exhibit No. 96, according to my records, was excluded at page 8232 of the transcript because it contained an estimate of the cost of rate case proceedings.

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Mr. Wheat: What about 93 and 97?

Mr. Littman: 97 was excluded at page 8332 of the transcript. That dealt with the purported variation in purchasing power of the dollar as related to gas plant.

Mr. Wheat: What about 93?

Mr. Littman: Your Honor will recall that Exhibit No. 97, in reality, was considered to be a reproduction cost [fol. 10640] study.

Mr. Littman: I beg pardon. 93?

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Trial Examiner: That was excluded, I think, on the 31st of March.

Mr. Wheat: Now, Mr. Examiner, the next one that I have—I think there were two offered by Commission's counsel, 106 and 107. I don't recall that those ever were admitted or offered for admission, but the next ones that we have on our list are 108, 109, 110, and 111, which are letters from Mr. Biddison to Panhandle Eastern Pipe Line Company in various years in respect to accruals for depreciation, depletion, and amortization.

These exhibits have been used by Mr. Smith in his study and by others. I offer them now for the record.

Mr. Littman: No objection.

Trial Examiner: The exhibits marked for identification as 106, 107, 108, 109, 110, and 111, will be received.

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Mr. Littman: Has your Honor ruled on Exhibits 106 and [fol. 10641] 107?

Trial Examiner: I admitted all of them, 106 to 111, both inclusive.

(The documents referred to were received in evidence as Exhibits 106 to 111, inclusive.)

* * * * * * * * *

Mr. Wheat: Then Witness Watkins' Exhibits 153, 154, 155, and 156. Most of these, I may say, were offered either [fol. 10642] by Michigan Gas Transmission, Consolidated Gas Company, or by Commission's counsel. The only one I wish to offer now is 153, which is the statement of cost of business development period April 1, 1932, to June 30, 1941.

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[fol. 10643] Trial Examiner: I have just compared excluded Exhibit 39 and the exhibit marked for identification as 153, and I am wondering about the competency of 153.

Mr. Littman: As I explained, your Honor, Exhibit 153 contains costs which were capitalized by the company.

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(The document referred to was received in evidence as Exhibit No. 153.)

Mr. Wheat: Then, Mr. Examiner, may we go to—I think [fol. 10644] Commission's counsel offered Exhibits 154, 155, and 156, which are documents furnished at his request by Mr. Watkins.

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(The documents referred to were received in evidence as Exhibits 154, 155, and 156.)

Mr. Wheat: I have nothing to say, of course, about 157, 158, and 159. We are not particularly interested in whether they come in or not.

Mr. Littman: No objection.

Trial Examiner: By whom were those exhibits presented: Mr. Chamberlain.—157-A and B, 157-C, 158, 159. I think all were presented by Mr. Chamberlain.

Mr. Littman: No objection.

Trial Examiner: They will be received.

(The documents referred to were received in evidence as Exhibits 157-A, B, C, 158, 159.)

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[fol. 10645] Trial Examiner: Mr. Culton, did you and Mr. Wheat carefully follow the motion to strike which Mr. Littman made with reference to your proposed Exhibit 75?

Mr. Culton: I am familiar with it, yes.

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Trial Examiner: Do you agree with Mr. Littman that that does exclude the evidence of value other than book [fol. 10646] cost, other than as recorded on the books of the company?

Mr. Culton: Frankly, Mr. Examiner, and that is what we are trying to be with you all the time, the philosophy in support of his objection to those portions of that exhibit are exactly the same as the philosophy in support of his objection to Exhibit 37 and Exhibit 37-A.

Trial Examiner: Well, of course, I am in sympathy with his view. I am simply inquiring whether the motion to strike, which I did not follow carefully, does reach that and no other parts of the exhibit in which you are interested.

Mr. Culton: I am sure that is correct.

Mr. Littman: I tried to confine my motion to strike purely to those parts that dealt with value.

Mr. Culton: That is the way I understood it.

Mr. Littman: That is your understanding, is it?

Mr. Culton: That is right.

Trial Examiner: As to Exhibit 75 for identification, being the statement of Mr. Ralph Davis, the motion to strike

which Mr. Littman has made will be sustained, and the exhibit, as so revised, will be received.

(The document referred to was received in evidence as Exhibit 75.)

Mr. Littman: Are you going to instruct the reporter to make proper marks and notations on the exhibit physically?

[fol. 10647] Trial Examiner: That may be done.

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Mr. Culton: Now, Mr. Examiner, may I complete the record on some points by making a tender of proof which I understand is in accordance with appropriate procedure?

Trial Examiner: Certainly

Mr. Culton: Relating to excluded exhibits.

Trial Examiner: Before you do that, Mr. Culton, the Trial Examiner has within recent days seen an order of the Securities and Exchange Commission which is included in the release of that agency No. 3415.

Because the record is replete in this proceeding with matters of similar character, I suggest that that order be included in our record and copies obtained for the files.

Mr. Wheat: What was the number?

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[fol. 10648] Trial Examiner: We will have it marked as Exhibit No. 258, and I am sure there can be no valid objection to its inclusion, so I will direct that it be received in evidence as soon as copies are furnished.

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Trial Examiner: Proceed, Mr. Culton.

Mr. Culton: Mr. Examiner, the Respondent companies make tender of proof of those portions of Exhibit 75, being the exhibit of Mr. Ralph Davis, which have just been excluded.

We offer each of those paragraphs separately.

We next make offer of proof of Exhibits 37 and 37-A of the Witness Wallace, 37-A being an exhibit containing certain correction sheets of Exhibit 37, and that exhibit purporting to show the market value of the leaseholds as of approximately the time this investigation commenced.

We point out in that connection that those leases represent real estate, and the language "reproduction cost" technically could not apply to that exhibit since the exhibit purports to reflect the then market value of the leaseholds, and the leaseholds not being physical property for which there is technically a reproduction cost, since it [fol. 10649] would take many millions of years to reproduce that gas.

Shall I proceed with the others, Mr. Examiner?

Trial Examiner: Surely.

Mr. Culton: In order to get these in order, we offer four exhibits, make tender of proof of four exhibits in one tender, being Exhibit 39, representing Mr. Biddison's reproduction cost new of plant property and business as of June 30, 1941, with Exhibit 39-A being correction sheets for Exhibit 39, with which we offer Exhibit 62, representing deduction from reproduction cost new for depreciation, showing present value of plant, property, and business, as of June 30, 1941, and Exhibit 70, which reflected reproduction cost new of plant property and business as of June 30, 1941.

Also separately from those four we offer Exhibit 17 prepared by Mr. Biddison showing valuation of property, plant, and equipment as of September 30, 1938.

We also, separately from the foregoing, but together, offer Exhibits 83, 84, and 86 as to the portions which were heretofore stricken, and in connection with them further offer Exhibit 97 showing a valuation based on variation of purchase price of a dollar. That was prepared by Mr. Spitznagle, those four being related documents, and all of these documents which we have offered are prepared for the purpose of tendering proof with respect to the matters reflected in those documents.

[fol. 10650] Trial Examiner: 83, 84; 86 and 97 were all presented by Mr. Spitznagle?

Mr. Culton: Mr. Haberly presented some of them, but Mr. Spitznagle's testimony was related to them.

Trial Examiner: Our practice contemplates the exceptions which were, I believe, in each instance granted when the exhibits were excluded.

You are also, of course, entitled to offer proof. Your offer of proof is denied and an exception is, of course, noted on the denial of this ruling to apply separately to your several stated offers, and the exhibits to which reference has been made will be appropriately endorsed by the Trial Examiner to be included in the exhibits filed.

In other words, an exhibit which has been excluded and is followed by an offer of proof will go into the file which merely entitles you, of course, to preserve the evidence which has been rejected by the Trial Examiner.

Mr. Culton: It is made a part of our tender, in other words?

Trial Examiner: That is true. The reporter, if he has these exhibits, will please deliver them to the desk in the morning, because each exhibit should be endorsed in accordance with this ruling.

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[fol. 10651] Mr. Littman: Well, I haven't heard counsel say that they rest and have no further testimony to present:

Mr. Culton: This is an investigation, Mr. Examiner. We don't know that there is any relining to take place. We stated that that is all of the testimony which we have—

Trial Examiner: You have no desire at this time, Mr. Culton or Mr. Wheat, to adduce any further evidence of any kind or character?

Mr. Wheat: Not at this time unless further evidence comes into the record which we feel should be properly rebutted.

Trial Examiner: On the record as it stands and as regards the defense which was contemplated by the order of the Commission in this matter, you do rest, do you not?

Mr. Wheat: Well, I think we stand silent, sir, before this bar.

Trial Examiner: You have concluded the presentation you desire to make?

Mr. Wheat: At this time, yes, sir.

Trial Examiner: Yes.

* * * * * * * *

[fol. 10659] SAMUEL JOSEPH, a witness, called on behalf of the Federal Power Commission, being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Littman:

Q. Will you please state your full name and present address?

A. My name is Samuel Joseph. I live in Arlington, Virginia.

Q. Will you state your education and experience?

A. I am a graduate of the Wharton School of the University of Pennsylvania. I received the degree of Bache-[fol. 10660] lor of Science in Economics from that University in June, 1928. I then attended the Columbia University Graduate School of Business Administration and did some work towards a Master's degree.

After leaving Columbia University I was employed in the public accounting field. I hold a certified public accountant's certificate from the State of New York. I am a graduate of Brooklyn Law School and hold the degree of Bachelor of Law. I am a member of the New York Bar.

Since 1934, I have been engaged in the public utility rate regulatory field. I have worked on state-wide investigations of telephone rates in Louisiana, Alabama and West Virginia. I have also worked on investigations of other utility companies, including electric, water and gas

utilities. I have testified before the Louisiana and Alabama Public Service Commissions and before the Public Service Commission of West Virginia.

At present and since August, 1939, I have been employed by the Federal Power Commission. I was first employed as a senior examiner of accounts and was assigned to the investigation of the Natural Gas Pipeline Company of America and Texoma Natural Gas Company as accounting examiner in charge. Last summer I was promoted to the position of principal examiner, which position I now hold.

Q. By the way, you just referred to an investigation [fol. 10661] of the Natural Gas Pipeline Company of America and Texoma Natural Gas Company. Are you referring to the investigation which recently was the subject of an opinion by the United States Supreme Court predicated upon an interim order adopted by this Commission?

A. That is the same investigation and same proceeding.

Q. Will you proceed with your statement of your education and experience?

A. I have taken part in the investigation of the following companies:

Southern Bell Telephone and Telegraph Company in the states of Louisiana and Alabama; New Orleans Public Service Company; Louisiana Power and Light Company; Louisiana Public Utilities Company; Baton Rouge Water Company; Chesapeake and Potomac Telephone Company of West Virginia; Wheeling Electric Company; Appalachian Electric Power Company; and Natural Gas Pipeline Company of America and Texoma Natural Gas Company.

Q. What is the nature of your present position with the Commission, Mr. Joseph.

A. Well, among certain other things, I am responsible for making studies and conducting research on the subject of fair rate of return for public utilities.

Q. Have you prepared an exhibit for purposes of this proceeding?

[fol. 10662] A. I have.

Q. I hand you a single sheet entitled, "Weighted Average Earnings-Price Ratios on Common Stocks 153 Stable Industrial Companies", and ask whether this is the exhibit which you prepared?

A. It is.

Mr. Littman: I ask, Mr. Examiner, that this exhibit be marked for identification with the next number.

Trial Examiner: It will be marked for identification as Exhibit No. 259.

(The document referred to was marked Exhibit No. 259 for identification.)

By Mr. Littman:

Q. Will you please describe Exhibit No. 259 which you prepared?

A. This exhibit has been compiled from material contained in Mr. Coffman's Exhibit No. 254 which he summarized on Chart No. 11 of Exhibit No. 253. The material is set forth in the same manner as that shown in the table supporting Chart No. 11 of Mr. Coffman's Exhibit No. 253.

The difference between the table supporting Chart No. 11 and the exhibit which I have prepared is that Mr. Coffman's table shows "Investors' appraisal of over-all capital risk 153 stable industrial companies" whereas my exhibit shows the earnings-price ratios on the common stocks [fol. 10663] of these same companies.

The period covered is the same, namely, 1937 through 1941, both inclusive.

Q. Why did you make these calculations, the results of which are set forth in Exhibit No. 259?

A. I am of the opinion that to the extent that the "153 stable industrial companies" chosen by Mr. Coffman are comparable with utilities generally or with natural gas pipe line companies that comparability relates chiefly to the common stocks, rather than to the "over-all capital".

The capital structure of the 153 stable industrial companies consists very substantially of common stocks. Utility companies, including natural gas pipe line companies, have a very much larger percentage of their capital repre-

sented by funded and long term debt and by preferred stock.

The annual cost in interest and preferred stock dividends of securities senior to the common stock of Panhandle Eastern Pipe Line Company have been fixed by the recent refinancing.

Chart No. 11 of Exhibit 253 and the material supporting that chart would be of very little, if any, assistance in an attempt to determine the proper allowance on the senior securities.

It, therefore, seems to me that if this material is usable by the Commission in finding a proper rate of return [fol. 10664] for Panhandle Eastern Pipe Line Company and its subsidiaries, then the earnings-price ratios on the common stocks are a better aid or guide than are the over-all ratios calculated by Mr. Coffman.

* * * * * * * * *

Q. Referring to your Exhibit No. 259 for identification, will you state what the weighted average earnings-price ratio is for these 153 stable industrial companies over the five years, 1937 to 1941, both inclusive, for the common stocks of those companies?

A. The weighted average shown on this exhibit is 7.43 per cent. I want to add that the weighting follows the method used by Mr. Coffman in his Chart No. 11 of his Exhibit No. 253.

Q. You mean the weighted average earnings-price ratio is 7.43 per cent? A. Yes.

Q. And you have followed the same method of weighting as was followed by Mr. Coffman in arriving at that percentage figure?

[fol. 10665] A. That is correct.

Q. There has been considerable evidence taken in this proceeding on the subject of earnings-price ratios. Will you comment briefly on the use of earnings-price ratios on common stocks in establishing a fair rate of return?

A. After earnings-price ratios on common stocks have been calculated the mathematical result cannot be used directly without the exercise of a considerable amount of judgment.

Your illustration, Mr. Littman, made during Mr. Coffman's cross-examination of the earnings-price ratio on brewery common stocks just before prohibition is to the point. The essential requirement is to determine, as accurately as possible, what rate the investor is demanding for the future.

The earnings-price ratio relates to past earnings. It is calculated by dividing past earnings by market prices. What is sought, however, relates to the future and the earnings-price ratios must be adjusted to eliminate those factors which are being discounted by the market price of securities.

Q. Will you please give us an illustration of your last statement?

A. Yes. Assume a company's common stock is selling at $30 per share. Assume that earnings during the last [fol. 10666] reported years were $3.60. The earnings-price ratio on this stock is 12 per cent.

Now, if the investor in this security thinks that prospective increases in taxes, or expenses, or the possibility of reduction in rates is such as to probably reduce future earnings to $2.70 then it seems clear that his true earnings requirement is 9 per cent; that is, $2.70 divided by $30, rather than the 12 per cent shown on the historical basis.

This discounting feature cannot be measured exactly, but an estimate of what has been discounted is nevertheless important.

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By Mr. Goodman:

Q. In plain language, Mr. Joseph, your last sentence means that the current profit realized in, say, the present year, cannot be taken as any measure of the future realization which the investor expects. That is an unknown, is that right?

A. You usually work from current earnings—

Q. (Interposing) Yes.

A. (Continuing) toward an estimate of what the investor actually requires for the future.

Q. I see.

[fol. 10667] A. In times like these, he probably has in mind that the earnings of the past will be reduced by prospective events such as increases in taxes.

Q. In other words, one cannot probe what is in the investor's mind merely by looking at the profit of the current accounting period. That is what you mean, isn't it, Mr. Joseph?

A. Well, the use of the unadjusted earnings-price ratio would not show what is in the investor's mind. Sometimes a very high earnings-price ratio would be a clearer indication that he expects a smaller profit, expects certain things to happen which will reduce that profit rather than that he expects a continuation of high earnings levels.

Q. Now, the matter can work conversely too, can't it?

A. At times it may.

Q. In other words, the current profit may be very small but the price at which the stock sells may be very high, indicating the prospective higher future earnings?

A. Situations like that have occurred, particularly before 1929.

Q. Well now, another thing, Mr. Joseph, logically, a long record of regular level profit yield is fairly generally accepted when conditions are normal and the outlook is normal as indicating the probable yield of the future.

Now, do you find anything in this particular evidence [fol. 10668] about which you testified that is consistent or inconsistent with that? In other words, do you have before you—

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[fol. 10669] Mr. Littman: Mr. Joseph, let me ask you this, do you understand the question?

The Witness: I think the question has two parts.

Mr. Littman: Suppose you answer the question, part by part in your own way. Perhaps that would be the best way.

The Witness: The first part of it, a stable level of earnings, would indicate in normal times that it was an indication of that level of earnings. That would probably be true if there is nothing to make the investor believe that

these stable earnings would change one way or the other and I assume that is what Mr. Goodman means by saying that the normal times will continue. In effect, he is saying if there is no reason why earnings shall change, then they will probably remain the same. I think there cannot be any quarrel with that.

Now, the second part of your question relating to testimony that has gone in here, I did not quite follow.

By Mr. Goodman:

Q. Do you find any testimony here that is calculated to set forth some continued past stable earnings under conditions that permit you to be able to say that such earnings will continue?

[fol. 10670]

A. Well, if I understand your question, I think the testimony is quite to the contrary.

Q. That is right. In other words, really you criticize the conclusion or disagree with the conclusion because of the lack of any showing to the probable effect that the earnings are stable earnings.

Mr. Wheat: Are you referring to these 153 stable industrial companies?

Mr. Goodman: Not at all.

Mr. Wheat: That is what the witness testified on, I thought.

Mr. Goodman: Now, you see you have injected something in there that simply confuses the subject and takes everybody off the track.

Mr. Wheat: I have not confused anybody's trend of thought and you know it.

Mr. Littman: Is there a pending question?

(Whereupon, the pending question was read by the reporter.)

Trial Examiner: Do you care to make some comment on that statement?

The Witness: I think both as respects the 153 industrial companies and as to the testimony on earnings-price ratios for utilities and for natural gas pipe line companies,

[fol. 10671] the market unquestionably is discounting future events.

By Mr. Goodman:

Q. Does it appear to you from the action of the market in that respect and from your general knowledge of the factors involved that the investor is assuming that current yields will or are representative of future yields?

Mr. Littman: By "yields", you mean earnings-price ratios?

Mr. Goodman: No, earnings-price ratios, that is something you figured.

* * * * * * * * * *

The Witness: I think that the earnings-price ratios of these 153 stable industrial companies and the earnings-price ratios of utilities and natural gas companies submitted by Mr. Coffman are somewhat higher than the investor actually expects will be achieved in the near future.

Mr. Goodman: That answers.

* * * * * * * * * *

[fol. 10672] Cross Examination.

By Mr. Wheat:

Q. Mr. Joseph, do you have before you Exhibit No. 153?

A. I have a copy here, yes, sir.

Q. And I wonder if you would turn to table supporting Chart No. 11? That table shows certain summary data, does it not, in connection with the study made by Mr. Coffman of these 153 stable industrial companies?

A. It summarizes the material submitted by Mr. Coffman in Exhibit No. 254.

Q. That is what I asked you. It does that, does it?

[fol. 10673] A. Yes, it does.

Q. And your Exhibit No. 259 has been made up in tabular form consistent with the table supporting Chart No. 11 so that we, if we wish to contrast the indicated market value of capital with what you have termed "indicated market value of common stock", we can ascertain the data

back and forth from the table supporting Chart No. 11 in Exhibit No. 253 and your Exhibit No. 259, can we not?

A. It is consistent in form, Mr. Wheat.

Q. That is what I asked.

A. It is not quite so consistent in theory.

Q. I have not asked you a thing about theory, have I?

Mr. Littman: Just a minute.

Mr. Wheat: I asked whether we could contrast, if we wanted to contrast these figures, Exhibit No. 259 with the table supporting Chart No. 11. That is similar in form to that of Exhibit No. 259, that is correct, is it not?

The Witness: Exhibit No. 259 is similar in form to table supporting Chart No. 11 in Exhibit No. 253, yes, sir.

By Mr. Wheat:

Q. Now, will you tell us what percentage the indicated market value of common stock for the year 1941 shown on your Exhibit No. 259, what percentage that figure bears to the indicated market value of capital for [fol. 10674] the year 1941 shown on Mr. Coffman's table supporting Chart No. 11 of Exhibit No. 253?

A. For the year 1941, the indicated market value of common stock is approximately 86 per cent of the indicated over-all market value.

Q. What was the similar percentage for the year 1940?

A. About 86.6 per cent.

Q. And for the year 1939? A. 87.1 per cent.

Q. And for the year 1938? A. 87 per cent.

Q. And for the year 1937? A. About 89.6 per cent.

Q. Now, will you tell us the percentage which the earnings available for common stock shown in the second and third columns on your Exhibit No. 259 bore in 1941 to the earnings available for capital shown in a similar position on Mr. Coffman's table supporting Chart No. 11 in Exhibit No. 253?

* * * * * * * * * * *

Mr. Wheat: You understand, Mr. Joseph, that what I want to contrast is your figure of $1,087,691 representing what you term "Earnings available for common stock" for

the year 1941 and Mr. Coffman's figure for the same year of $1,166,698 which he has under the caption, "Earnings [fol. 10675] available for capital". I would just like to have you tell us the percentage which the one bears to the other.

The Witness: I have not calculated those.

By Mr. Wheat:

Q. Would you mind doing that for us? It is a simple matter and I would like to have you do it for each of those five years, please.

Mr. Littman: For how many years are you going to want that?

Mr. Wheat: I said five years. There are five figures there, that is all. It is a simple mathematical calculation, isn't it?

The Witness: Rather simple. I would like to use a calculating machine to do the figuring, if I can.

Mr. Wheat: I have got some approximate figures if you wish me to give them to you.

Mr. Littman: Let's have your figures subject to check, Mr. Wheat. Perhaps it will save time.

By Mr. Wheat:

Q. For the year 1941, 93 per cent. That is the ratio of earnings available for common stock as stated by Mr. Joseph and earnings available for capital as stated by Mr. Coffman. Does that sound reasonable to you?

A. Yes, it does.

[fol. 10676] Q. And for 1940—93 per cent; for 1939—92 per cent; for 1938—90 per cent, and, for 1937—94 per cent.

Do those figures seem reasonable to you? Of course, they are subject to your check.

A. Yes, they appear to be reasonable.

The first figure I gave you, Mr. Wheat, when you asked about the relation of the indicated market value of common stock for 1941 related to the indicated market value of capital shown in Mr. Coffman's exhibit, I said was 86 per cent.

Q. I think that is correct.

A. I have it here 86.2 per cent. I gave you the place behind the decimal for the other figures and I give it to you on this figure.

* * * * * * * * * * *

Mr. Littman: I have one or two matters that might well be disposed of at this time.

At page 4384 of the transcript, I requested Dr. Bartle to supply certain information with respect to the production in the Hugoton Field by the two largest producers in that field, to wit, by Panhandle Eastern Pipe Line Com- [fol. 10677] pany and Northern Natural Gas Company. He responded quite promptly to my request. However, I just did not get around to reporting his prompt reply to my request until today.

Now, his response is on a single sheet and contains data which may very well be copied into the record at this point. The substance of Mr. Bartle's response is that, for the year ended July 1, 1941, Panhandle Eastern produced 40.7 per cent of the total production from the Hugoton Field and Northern Natural produced 49.1 per cent, a total in percentage of the two companies of 89.8 per cent of the total production from the field. That would leave approximately 10 per cent produced by others.

For the year ended July 1, 1940, the comparable percentages are for Panhandle Eastern, 41 per cent and Northern Natural, 44.7 per cent, a combined percentage of 85.7 per cent.

For the year ended July 1, 1939, the percentage was, for Panhandle Eastern, 40.4 per cent and for Northern Natural 46.5 per cent, a combined percentage of 86.9 per cent.

This sheet contains the M.c.f. figures and appropriate titles and I am going to ask that the data be copied into the record as given to me by Mr. Bartle.

Trial Examiner: This statement of Dr. Bartle's, I assume, has been submitted to counsel for the company?

[fol. 10678] Mr. Culton: We delivered it to counsel for the Commission, Mr. Examiner. We have no objection to it.

Trial Examiner: The reporter will copy this statement into the record as requested.

[10679]

Production from the Hugoton Field

Total metered production from Hugoton Field (Kansas and Oklahoma)	37,905,071 M. C. F.	36,896,130 M. C. F.	32,017,511 M. C. F.
Production which went into Panhandle Eastern Main Line system	15,442,651 M. C. F.	15,133,288 M. C. F.	12,960,792 M. C. F.
Production which went into Northern Natural Gas Company Main Line system	18,625,482 M. C. F.	16,497,542 M. C. F.	14,892,785 M. C. F.
Panhandle Percentage	40.7 %	41.0 %	40.4 %
Northern Natural Percentage	49.1 %	44.7 %	46.5 %
Combined Percentage	89.8 %	85.7 %	86.9 %

[fol. 10680] Mr. Littman: At pages 5931 to 5933 of the transcript for January 19, 1942, I requested Mr. Hinton to furnish certain information with respect to the status of his estimated proposed 1942 construction program and also for subsequent years which estimates are set forth from pages 27, et seq., of his Exhibit No. 42.

Now, Mr. Hinton has responded promptly to this request, I having received the response within a matter of a week or ten days after my request, and I do not want to charge Mr. Hinton with the delay. I simply did not get around to having these sheets marked for identification until today. It is my fault, not Mr. Hinton's.

I would, therefore, like to have marked for identification Mr. Hinton's response to that request, a document consisting of three pages, entitled, "Panhandle Eastern Pipe Line Company Status of Proposed 1942 Construction Program—Production and Gathering System South and West of Liberal Station (Pages 27 and 28 of Exhibit 42)".

* * * * * * * * * * * * *

(The document referred to was marked Exhibit No. 260 for identification.)

Mr. Wheat: I take it, Mr. Littman, that you understand, as I do, that this Exhibit No. 260 for identification refers to the status of this construction program as of the date [fol. 10681] on which you asked your question or approximately that date?

Mr. Littman: Yes.

I would like to ask Mr. Culton whether I am correct in understanding that the reason no details of the status of the 1943 construction program and for the years subsequent thereto were not presented by Mr. Hinton in Exhibit No. 260 was simply because there is no status? In other words, that construction has not reached any stage of presentation to the Board of Directors?

Mr. Culton: My understanding is that there is no occasion to do those things that are scheduled for 1943 before 1943 comes around unless it is by reason of a change of plan which might result from the circumstances that Mr. Hinton and Mr. Creveling referred to and, obviously, there

would be no necessity to show any status as to the wells which are to be drilled in 1943. If you will look at the items mentioned for 1943, I think you will readily recognize that there could be at this time no status for those particular items.

Mr. Littman: Yes, I assumed as much but I wanted to make certain my understanding was correct.

I offer in evidence Exhibits Nos. 259 and 260.

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[fol. 10682] (Exhibits Nos. 259 and 260 were received in evidence.)

* * * * * * * * * * *

[fol. 10698] Mr. Littman: Mr. Examiner, before asking Mr. Shattuck of our staff to take the stand, I would like to have two exhibits marked for identification.

The first document was supplied to us at our request by Mr. O. W. Morton of Panhandle Eastern Pipe Line Company. His letter of transmittal reads as follows, under date of April 9, 1942:

"Federal Power Commission
"Washington, D. C.

"Attention: Mr. Littman

"Gentlemen:

"Upon the occasion of your last visit to Kansas City, you requested certain data relative to coincidental and non-coincidental maximum days. You, no doubt, recall that the request originated out of a telegram from Mr. Zinder and that we discussed the request at some length with Mr. Shattuck.

"The attached data has been prepared in response to that request and in accordance with our conversation with Mr. Shattuck. It consists of one tabulation comprising four sheets entitled 'Approximate Coincidental Maximum Day Sales' and a single sheet entitled 'Direct Industrial Sales'. Two copies are enclosed.

[fol. 10699] "Please advise if further data or explanation is required.

"Sincerely

"(Signed) O. W. Morton"

I ask that the document referred to by Mr. Morton be marked for identification with the next exhibit number.

* * * * * * * * * *

(The document referred to was marked Exhibit No. 261 for identification.)

* * * * * * * * * *

Mr. Littman: I next wish to read into the record a letter dated April 11 from Mr. O. W. Morton regarding this same subject matter.

[fol. 10700] "Federal Power Commission
"Washington, D. C.

"Attention: Mr. Harry S. Littman

"Gentlemen:

"Supplementing our report of Maximum Day Sales sent to you under date of April 9, 1942, we enclose herewith a report which we prepared in January showing the quantity of gas curtailed during the period January 4 to 12, on the Panhandle Eastern main line system.

"You will note that total curtailments on the maximum day, January 7, were 20,210 MCF and that subsequently the amount curtailed increased daily until it rose to a maximum of 25,022 MCF on Saturday, January 10.

"We do not have the record of curtailments of Michigan Gas Transmission Corporation but are advised that there was no curtailment on the 7th of January and that curtailment of industrial customers started on January 8th and increased for several days thereafter to an amount roughly estimated at ten million cubic feet daily.

"Yours very truly

"(Signed) O. W. Morton"

I ask that the data referred to in Mr. Morton's letter of April 11, 1942, which consists of one page of fabulations be marked for identification as Exhibit No. 262.

Trial Examiner: It will be so identified.

* * * * * * * * * *

[fol. 10701] (Exhibits Nos. 261 and 262 were received in evidence.)

* * * * * * * *

J. G. SHATTUCK, a witness, called on behalf of Federal Power Commission, being first duly sworn, was examined and testified as follows:

Direct Examination.

By Mr. Littman:

Q. Will you state your full name and address, please?

A. J. G. Shattuck, Washington, D. C.

Q. By whom are you employed, Mr. Shattuck?

A. By the Federal Power Commission.

Q. What is your present capacity with the Commission?

A. I am an engineer with the Bureau of Accounts, Finance and Rates.

Q. And how long have you been so employed?

A. I have been employed by the Bureau of Accounts, Finance and Rates for about 3½ years, first as an asso-[fol. 10702] ciate engineer and then later as an engineer.

Q. Will you briefly state your education and experience, Mr. Shattuck?

A. I received my engineering education at Leland Stanford, Jr., University. I received an A. B. degree in Civil Engineering in 1928. I spent the following year in graduate study in the same university.

During my attendance at the University, I worked in its Corporation and Stores Department which handled all maintenance and new construction work for the University and for the residences situated near the University. This work included the development of additional residential sites, the construction of residences, the construction of new buildings and the extension of water, electricity and gas facilities to them. During this same period, I also

assisted engineers in the design and installation of street and utility construction for residential developments.

After leaving the University, I took charge of the engineering of a large community development near San Francisco, which work included design and construction of roads, water supply and small dams to provide recreational lakes. At the same time, I acted as consulting engineer and, in many cases, had direct charge of similar projects located near San Francisco.

In October, 1929, I became Assistant Engineer with the [fol. 10703] Department of Public Works of the City of Palo Alto. In this position, I handled the sewerage and water supply problems of the city, together with occasional work upon street improvements and the water, gas and electric utilities. Cost analysis and cost accounting and the study of operating costs with the end of reducing unit costs were an important part of my work.

In October, 1932, I became Gas Engineer for the City of Palo Alto, having charge of the receipt and distribution of natural gas in that city. I made a study and developed a method of reducing the amount of gas lost in operating this distribution system. I also made a study of the cost of production and transmission by the company which sold the city gas at wholesale.

Trial Examiner: Is that a municipal plant?

The Witness: That is a municipal plant, sir.

In connection with that work, I also studied the operations and costs of other California gas companies. While with the City of Palo Alto, I assisted in the design and had charge of the construction of an auxiliary gas plant. During my services with the city, major pipe line changes were necessary due to rerouting of the gas and existing inadequacy of capacity. These changes, additions and improvements were practically completed before I left the employ of the city in June, 1938. In addition to the specific work of Gas Engineer for the city, I also designed [fol. 10704] the methods and supervised the taking of an inventory of the gas plant and system and the electric system and supervised the preparation of plant system maps and records. My work for the city included studies

of the retail electric and gas rates and the design of new rates for each rate reduction given to the customers periodically.

In July, 1938, I became Field Engineer for California, Area 9, of the Works Progress Administration. In that capacity, I had direct charge of receiving and examining all proposals made in that area for construction projects. In addition, I had direct charge of all work being done in the area on construction projects, which entailed the planning of the programs, procedures and alterations in such specifications as necessary to continue the work of each project.

From graduation from the University until January, 1939, I also acted as consultant either separately or together with other engineers on numerous problems covering practically all phases of civil engineering, except large structural design, and on utility matters.

In January, 1939, I accepted an appointment as Associate Engineer with the Federal Power Commission and was assigned to the Bureau of Finance, Accounts and Rates. In this capacity, my work consisted of the study of rates, contracts, investigations and reports on new rates and rate changes filed by natural gas companies and elec- [fol. 10705] tric public utilities. In November, 1941, I was given the position of Engineer with the same Bureau. In connection with my work for the Commission, I have assisted in the investigation of natural gas companies of which the principal ones are the Hope Natural Gas Company, the Peoples Natural Gas Company and the Panhandle Eastern Pipe Line Company and its subsidiaries.

By Mr. Littman:

Q. Mr. Shattuck, have you prepared an exhibit for presentation in this proceeding dealing with the subject of allocation of adjusted 1941 costs as between what has been characterized as "regulated and non-regulated sales"? A. I have.

Q. I hand you an exhibit entitled "Panhandle Eastern Pipe Line Company and Subsidiaries—Allocation of Adjusted 1941 Costs between Regulated and Non-regulated Sales" and ask whether this is the exhibit to which you have just referred? A. It is.

(The document referred to was marked Exhibit No. 263 for identification.)

* * * * * * * * * *

[fol. 10706] Q. Is my understanding correct, Mr. Shattuck, that page 1 of Exhibit No. 263 for identification contains a summary of your study with respect to allocation?

A. It does.

Q. Will you please briefly explain this exhibit?

A. In this study, I have taken the costs of service, which have been previously testified to in this case, which are summarized in Exhibit No. 195 presented by Witness Watkins, and have allocated those costs to two divisions or [fol. 10707] types of costs, those proportional to maximum day sales and those proportional to annual sales.

I have taken the result of that division of costs and the proportions of the so-called regulated sales and non-regulated sales as they were set forth and defined in Exhibit No. 251 and determined the portion of each of the costs, those proportional to maximum day sales and those proportional to annual sales which are appropriately allocated to regulated sales and the portions which are properly allocated to non-regulated sales.

Q. Will you explain what you mean by the terms "regulated sales" and "non-regulated sales"?

A. I have taken the division of the sales as shown in Exhibit No. 251 and have used the same words to designate each group as used by Mr. Spacek. I understand the term "non-regulated sales" to refer to the direct industrial sales made from the Panhandle Eastern Pipe Line system and from the Illinois Natural Gas Company system and no others. I understand the "regulated sales" as defined to include all other sales made by Panhandle Eastern and its subsidiaries.

Q. And the last class of sales are sales for resale?

A. Yes—excuse me, not all of them are sales for resale. There are some sales to residential, commercial and rural customers included in that.

Q. I see, but those are of rather minor importance, are [fol. 10708] they not? A. They are very small.

Q. Will you please proceed with your explanation of Exhibit No. 263?

A. I think it will be more direct to begin on page 2 and follow the detail through and then go to the conclusion on page 1.

Q. Very well. You may explain Exhibit No. 263 in the fashion you deem will best expedite matters.

A. The identifications shown on pages 2 and 3 on the left-hand side are those used by the company in its exhibits presented by Mr. Watkins, Mr. Spacek and others in so far as I could use them so that the accounts may be followed from their exhibits to this directly.

The 1941 costs on page 2 in Column (A) and on page 3 in Column (A) down as far as line 5, are those expenses which are shown in Exhibit No. 203. The items in line 7, page 3, to line 14, page 3, Column (A), are taken, in the most part from and do conform exactly with similar items in Exhibit No. 195.

The total of taxes, as shown in Column (A), is the same as the total of taxes in Exhibit No. 195.

Q. Exhibit No. 195 was one of Mr. Watkins' exhibits, was it not?

A. It is Mr. Watkins' exhibit entitled "Pro Forma [fol. 10709] Consolidated Income Account for the Year Ended December 31, 1941".

Q. Will you proceed with your explanation of Exhibit No. 263?

A. The utility revenues which are stated in lines 32 and 33 of page 3 and credited against the 1941 costs are those shown in the right hand column of Exhibit No. 195 as gasoline sales and miscellaneous sales.

In Column (B) of pages 2 and 3, I have entered certain adjustments.

Q. Will you explain the character of those adjustments, Mr. Shattuck?

A. In lines 12 and 13 with the total on line 14

On page 2, Col. B, are the items of expense which apply to the transmission operating expenses as testified to by Mr. Watkins and shown in Exhibit No. 248 which are the increase in operation expenses resulting from the inclusion of certain authorized costs not fully included in the expense for the year 1941.

Q. I take it you have just read from the title of that exhibit, have you not?

A. I read from Note 1, page 3 of that exhibit.

Q. Very well. Does that complete your explanation of the transmission expense adjustments in Column (B), [fol. 10710] page 2?

A. No. In line 38, item $94,000 is the balance of the increased costs which total, in Exhibit No. 248, $389,000, and is also the result of the increased expenses not fully included in 1941 expenses.

On page 3, line 12, in Column (B), "Adjustment", is a deduction of the amortization charged for certain sales and purchase contracts. This deduction is made in accordance with the testimony of Mr. Dunn.

Q. Are you referring, Mr. Shattuck, to the deduction of the amount of $230,173.96 of annual expense shown in line No. 12? A. Yes, sir.

Q. Very well. Proceed with your explanation of page 3.

A. In line 13, Column (B), there is a deduction of $62,854.64, which is the amount of the amortization for other sales and purchase contracts as testified to be proper to be deducted from the 1941 costs by Mr. Dunn.

The total of those two adjustments to amortization of sales and purchase contracts amounts to $293,028.60.

Q. Are you referring to Mr. Dunn's testimony to the effect that this sum of $293,000-odd is being annually charged for the purpose of amortizing what Mr. Dunn has characterized as a "write-up"? A. Yes, sir.

[fol. 10711] In line 26, Column (B), and line 27, Column (B), are items making a total net deduction of $182,000 from Federal income and excess profits taxes. This amount is the result of taking the $100,000 adjustment shown in the line for total operating revenue deductions of Exhibit No. 195 as testified to by Mr. Watkins and the adjustment in line 18 of Exhibit No. 248 testified to by Mr. Watkins of $282,000, making a net deduction of $182,000.

The effect of these adjustments is to make the 1941 costs those costs which Mr. Watkins testified to in Exhibit No. 195 in the column entitled "Consolidated" with the ex-

ception of the deduction made in accordance with Mr. Dunn's testimony.

That finishes my discussion of adjustments.

Q. Now, what amount does that leave as the total expenses to be allocated after the adjustments which you have described? A. $10,443,338.53.

Q. Very well. Now, will you proceed with your explanation of how those expenses, after adjustment, are allocated in your Exhibit No. 263?

A. The total which I just read and the items which make up that total are shown in Column (C).

Q. On what page?

A. On pages 2 and 3. The amounts shown in Column (C) have been allocated in three groups: those costs which [fol. 10712] are considered to be proportional to maximum day sales shown in Column (D), those costs which are considered to be proportional to annual sales in Column (E) and certain other costs shown in Column (F). These other costs are the costs incurred by the Indiana Gas Distribution Corporation with the exception of a very small item of gas purchase expense and a credit to production expenses.

The costs placed wholly in the maximum day's sales column, Column (D), are transmission mains expense, line 12—$350,833.19; pumping station structures, maintenance expenses, line 17—$23,897.91.

Q. That is on page 2, is it?

A. Yes, sir.

Mains, maintenance expenses, line 18—$94,212.01.

Certain other expenses have had a portion allocated to maximum day's sales, Column (D). These are operation supervision and engineering; maintenance supervision and engineering; and administrative and general expenses. The proportion of those three accounts which have been placed in the maximum day's sales column have been arrived at in accordance with the proportion of the supervised expenses under such supervision and engineering. For example, the supervision and engineering in line 11 of $134,205.46 has been prorated to the two columns, maximum day's sales and annual sales, in accordance with a

[fol. 10713] proportion of $350,833.19 to the item $1,319,-812.99. Similarly, the supervision and engineering of $48,-127.64 has been apportioned at the ratio of the sum of the items, $23,897.91 and $94,212.01 to the amount of $172,-819.71.

The administrative and general expenses shown in line 38 of $941,847.69 have been divided between maximum day's sales column and annual sales column in proportion to all of the expenses which appear above that line on page 2.

Turning to page 3, the item, "Miscellaneous revenue deductions" shown in line 3 of $11,499.33 has been placed in Column (E) under "Annual sales".

I would like to call your attention to the fact that in line 33, the revenues comparable to those costs—I would like to correct my testimony. I misread.

Back in line 3, miscellaneous revenue deductions, the amount of $11,449.33 has been put in the column "Annual Sales" except for $462.39 which was incurred by the Indiana Gas Distribution Corporation. Similarly, in line 33 of the same page, the miscellaneous revenues comparable with those costs have been similarly placed. The total amount of $12,309.09 is divided between the "Annual Sales" column, $11,645.35, and the "Other" column which is the revenue received by the Indiana Gas Distribution Corporation of $663.74.

The division of depreciation, depletion and amortization [fol. 10714] expenses or charges has been broken down into separate parts so far as possible from the financial statements of the company and from the exhibits in the record. The depletion of the producing leaseholds was considered as proportional to annual sales. The amortization of non-producing leaseholds was considered as proportional to annual sales. The depreciation of gasoline plant has been considered as proportional to annual sales and the amortization of the portion of the sales and purchase contracts not eliminated, in accordance with Mr. Dunn's testimony, has also been placed in annual sales.

The remainder of that item is the depreciation of gas plant shown in line 10 of $2,242,521. From that has been

deducted $3,740.80 which is the depreciation shown for the property of the Indiana Gas Distribution Corporation and that amount was placed in Column (F). The remainder of depreciation of gas plant was proportioned between maximum day's sales and annual sales column in accordance with the proportion arrived at in this fashion.

From the total classified gas plant account of $78,216,584, there has been deducted as not properly a part of the depreciable property, the intangible plant, distribution plant, deducted because the depreciation on the Indiana corporation has been taken from the amount—

Q. (Interposing) And that is shown as included in [fol. 10715] Column (F), isn't it?

A. That is right, an item of approximately $20,000 undistributed fixed capital.

The item of leaseholds amounting to about $1,750,000 since the depletion and amortization of those leaseholds has been provided for elsewhere and the gasoline plant for the same reason.

That leaves an estimated depreciable property base of $75,308,521. To obtain a ratio between the maximum day's sales and the annual sales, I have further divided that estimated depreciable property amount by taking the amounts in the accounts for land rights, mains, pumping station structures, pumping station equipment and a portion of general plant as representing the proportion of depreciation to be included in maximum day's sales and the amount of plant in production less leaseholds and gasoline plant, transmission land, metering and regulating structures, other transmission structures, metering and regulating equipment, other transmission equipment and the remaining portion of general plant as representing the proportion of depreciation to be included in the annual sales Column (E). Those factors are for maximum day's sales column, 0.93549 and, for annual sales column, 0.06451.

The division of taxes has been done separately by character of taxes in so far as possible. Gross production [fol. 10716] and sales taxes have been allocated to the cost apportioned to annual sales. Ad valorem taxes have been divided by the same factors used in dividing depre-

ciation. Franchise taxes have been assigned to those costs proportional to annual sales. Capital stock taxes and income taxes, excess profits taxes and charges in lieu of income and excess profits taxes have been divided between maximum day's sales and annual sales, half and half.

Gasoline sales, as a credit against costs, have been placed in the annual sales Column (E). I would like to point out, in that connection, that all the operating expenses of the gasoline plant, all the depreciation, in fact all costs of the gasoline plant have also been placed in the annual sales column.

I have already described the disposal of the miscellaneous revenue item in line 33. The result of this allocation is to arrive at a total of $5,222,002.87 of costs proportional to maximum day's sales, a total of $5,177,647.77 of costs proportional to annual sales and an amount of $43,687.89 of other costs not assigned to either.

Q. Now, does that complete your detailed explanation of the detail of pages 2 and 3 of Exhibit No. 263?

A. I believe so.

Q. I think perhaps it might be well for you to dwell for a moment on page 1 of Exhibit No. 263 and briefly explain [fol. 10717] the figures shown there, if you will, Mr. Shattuck?

A. In Column A, lines 3 to 7, I have transferred the totals that I have just read of approximately $5,200,000 of costs proportional to maximum day's sales and $5,200,000 of costs proportional to annual sales, to assign a portion of the item, $5,222,003 to the so-called regulated sales and the so-called non-regulated sales, I have taken a proportion arrived at by comparing the peak day use on January 7, 1942 of the two characters of service. On that date, Panhandle Eastern Pipe Line Company and Illinois Natural Gas Company, as described in Exhibit No. 261, sold and delivered from its system west of Dana 75,293,000 cubic feet of gas of which 6,748,000 cubic feet were delivered to the so-called non-regulated sales and 68,545,000 cubic feet to the so-called regulated sales.

In Exhibit 79-A, Witness Young, it is shown that east of Dana from the system of the Michigan Gas Transmission Corporation, that the total delivery on that date was

175,435,000 cubic feet, all of which was delivered to regulated sales. The total of these amounts show that the total sales from the combined system of Panhandle Eastern and its subsidiaries was 250,728,000 cubic feet on that day of which 6,748,000 were delivered to non-regulated sales and 243,980,000 to regulated sales. The fractions representing this proportion are, regulated sales—0.9731; and, non-regulated sales—0.0269.

[fol. 10718] Using these factors directly on the amount of $5,222,003, I have found an amount of $5,081,531 of costs proportional to maximum day's sales allocated to regulated sales and an amount of $140,472 allocated to non-regulated sales.

Q. That is shown in line 3 of page 1 of Exhibit No. 263, is it not? A. Yes, sir.

In line 4 of page 1 is shown the division of the costs proportional to annual sales. These costs have been divided in accordance with the division of sales shown in Exhibit 251 in line 10 and are represented by the fractions 0.8680 to regulated sales and 0.1320 to non-regulated sales. Applying these factors to the costs proportional to annual sales, I arrived at an amount of $4,494,198 allocated to regulated sales and $683,450 allocated to non-regulated sales.

Q. What are the totals of the costs shown in this exhibit allocated as between the regulated and the non-regulated sales?

A. The costs which are allocated between regulated sales and non-regulated sales are, in total, $10,399,651 and they are divided $9,575,729 to regulated sales and $823,922 to non-regulated sales.

Q. Now, to summarize, is my understanding correct, Mr. Shattuck, what you have done here is to start with the [fol. 10719] costs shown in certain of the company's exhibits and then make certain adjustments and then go on from there and allocate to the final figures which you have just read. Is that generally a correct summary of what you have done?

A. Yes, sir.

Q. And, of course, as the Commission may change the starting figures, the allocated figures would, of course, vary accordingly?

A. Yes, sir.

Q. Now, nowhere, as yet, have you mentioned the subject of return. I take it you have not included in Exhibit No. 263 any allocation of return?

A. I have not included in the costs shown in this study any amount for return. I would have done so had I known the amount to have included, as I consider that one of the costs of service.

Q. Now, will you give us your best judgment as to the method properly, in your opinion, to be used for the allocation of return without reference to dollars because, as I understand it, we have no definite figure in the evidence, that is to say, we, as yet, do not know what the Commission will decide is the fair amount of return?

A. If I had had the amount of the return, I would have added another line, in fact two lines, to page 3 and I would have divided the amount of the return half and half be- [fol. 10720] tween maximum day's sales, Column (D), and annual sales, Column (E), and I would have added that to line 36 to have arrived at a total cost.

Q. Then you would have taken the totals thus secured and divided them as shown on page 1 of Exhibit No. 263?

A. Yes, I would have used those new totals instead of the totals shown in lines 3 to 7, in Column (A), and would have proceeded in the same fashion from that point on.

Q. Have you completed your explanation of Exhibit No. 263, Mr. Examiner?

A. I believe so.

Mr. Littman: We have endeavored, if your Honor please, to make a full and complete explanation of this exhibit on direct examination. I hope we have succeeded in making the exhibit clear.

* * * * * * * * * * *

[fol. 10721] Mr. Littman: We offer in evidence Exhibit No. 263.

* * * * * * * * * * *

(Exhibit No. 263 was received in evidence.)

Mr. Littman, Mr. Examiner, I have threatened from time to time on the record to ask, with consent of counsel, to have incorporated in this record, by reference, all of the rate schedules of Illinois Natural Gas Company, Michigan Gas Transmission Corporation and Panhandle Eastern Pipe Line Company. I have found that there are a great many of such rate schedules on file with the Commission. Obviously, these rate schedules set forth the very rates that are in issue in this proceeding and, to my mind, those rates should be made a part of this record.

In order to facilitate the matter of incorporating into [fol. 10722] the ~~record, by reference~~, these rate schedules, I have had prepared an index of each and every one of the rate schedules that was on file with the Commission as of February 1, 1942, so that ready identification is available from this list.

Perhaps it would be best to have the list, or the index of these rate schedules, marked for identification as an exhibit so that the detailed rate schedules may be readily identified as the ones which are incorporated in the record by reference but, before doing that, I would like to now formally request Your Honor to incorporate, by reference in the record, all of the rate schedules on file with this Commission as of February 1, 1942, of the three respondents, to-wit, Illinois Natural Gas Company, Michigan Gas Transmission Corporation and Panhandle Eastern Pipe Line Company, a list of which is contained in the schedule which I have in my hand and will ask to have identified as an exhibit, if you will permit the incorporation by reference.

Trial Examiner: This index will be marked for identification Exhibit No. 264.

(The document referred to was marked Exhibit No. 264 for identification.)

. . . .

[fol. 10726] (Exhibit No. 264 was received in evidence.)

(The rate schedules listed in Exhibit No. 264 are received in the record, by reference.)

Mr. Littman: Mr. Examiner, I would also like to h incorporated into the record by reference certain schedules which have been transmitted by Panhandle E ern Pipe Line Company and Michigan Gas Transmis Corporation to which numerous reference has been m in this record.

[fol. 10727] These are the schedules which have not come, as yet, effective.

Mr. Watkins referred to them on a number of occasio There is some question at this moment as to the prec status of these schedules. No formal action, as I und stand it, has yet been taken with respect to them.

You understand the ones to which I am referring, Culton, are the ones to which you just referred a mom ago. Is that right?

Mr. Littman: I think, in order to have a complete r ord, we ought to have these incorporated.

Now, if Your Honor sees fit to have these incorpora by reference, I will prepare a list similar to the list wh has been identified as Exhibit No. 264 and present it your Honor as Exhibit No. 264-A within the next few da I would like to reserve an exhibit number for these pa ticular schedules. I think, in view of the testimony h in evidence with respect to these proposed rate schedu and with respect to the effect that these rate schedules m have upon those which are now on file as shown in Exhi No. 264, that, in order to make a complete record, the ought to be incorporated.

I might say to Your Honor that if this case were, pe chance, to go to an appellant court in the future then, I u [fol. 10728] derstand counsel can agree as to what portio of the record may be required to be printed and tran mitted to the appellant court and if seems to me that these documents are bulky and are too numerous to transmitted and if there is no particular necessity at th time, I am sure counsel will have little difficulty agreein on what parts are necessary for printing and what par are not. In other words, I think we can cross the bridge to the reprinting of these documents for the later record such occasion should arise when the time comes.

These documents, of course, will remain as they always have, in the Commission's own files and may be referred to. I see no particular inconvenience to anyone and, as a matter of fact, I see a great deal of merit in having all of these in.

* * * * * * *

[fol. 10729] Trial Examiner: The pending offer contemplates the inclusion into evidence of six folders and the contents or parts of the contents including correspondence between the several companies involved and the Federal Power Commission, both letters received and copies of letters written. It will be very easy to make an obscure record [fol. 10730] at this point. The suggestion which counsel have made in which, apparently all concur, will be adopted.

Mr. Littman will be requested to file, within three days, an index specifying the exact documents or letters which are included in the ruling about to be made and furnish a copy of that index to all counsel.

Since you are all willing to rely on Mr. Littman's discretion in this regard, we will have that index, when it is filed with the Trial Examiner, marked for identification as No. 265 and the several letters and documents designated in that index to be prepared by Mr. Littman will then be received in evidence, by reference.

(The document referred to, when received, will be marked Exhibit No. 265 and received in evidence.)

(The data listed on Exhibit No. 265, to be submitted, will be received, by reference, in the record.)

Mr. Littman: Mr. Examiner, I now request that there be incorporated into the record by reference the 1939, 1940, and 1941 Annual Reports of each of the respondents, Panhandle Eastern Pipe Line Company, Michigan Gas Transmission Corporation and Illinois Natural Gas Company.

Trial Examiner: You mean the Annual Reports to the Federal Power Commission?

Mr. Littman: Yes, those reports for the years 1939 and [fol. 10731] 1940 have been received and are on file. The 1941 reports, I understand, have not yet been received but will very shortly, I believe probably before the end of the month, be received and, in my judgment, I believe that

sworn statements of the companies with respect to their operations and matters shown in those Annual Reports should be made a part of the record so that reference to them may be made.

I might say that those Annual Reports are not very bulky.

* * * * * * * *

(The annual reports for the years 1939, 1940 and 1941 of respondents are received in the record, by reference.)

* * * * * * * *

[fol. 10738] Mr. Goodman: I present the joint motion of the City of Detroit and the County of Wayne for an order reducing rates of the Defendants forthwith and pending any further investigation by the Commission.

I hand to the Bench five copies and on one of the copies there is endorsed a certificate of service which I will now make.

Mr. Wheat: May I ask, Mr. Goodman, have these documents or any of them been filed with the Secretary of the Commission?

[fol. 10739] Mr. Goodman: No.

Mr. Wheat: As prescribed by the rules—I suppose that is going to be arranged?

Trial Examiner: The Trial Examiner will attend to those matters.

* * * * * * * *

[fol. 10747] Trial Examiner: Now, the other matter in which counsel are probably all interested is the matter of briefs. A trial balloon was released day before yesterday in this matter of briefs and since the remarks of the Trial Examiner, various discussions have occurred here, there and elsewhere and I am also myself under a firm commitment.

The City of Detroit seems quite anxious to have this case submitted and the Trial Examiner has definitely undertaken to file a report or to complete his report, at least, in this case, whether it is actually filed, by June 15. In view of that, the Trial Examiner will now fix the time for the concurrent principal briefs at May 20 and the reply briefs at June 1.

Mr. Culton: Mr. Examiner, you are putting an impossible situation on us there.

Trial Examiner: I want to remark this, gentlemen, that we cannot quite apply normal rules and normal procedures to a time like this. I want your briefs and I know you want to furnish them. If they are going to be any good to me in [fol. 10748] submitting this proceeding to the Commission on the present record, I must have them at the times indicated. It means that not only you but also I work continuously right through from now until, in my case, June 15, more or less day and night. It is a continuous assignment for all of us until we dispose of this.

The case is, after all, rather a simple case. We do not have to analyze and weight evidence to any great extent in it and certain of the questions of law, by which we were in doubt when the proceeding commenced, have been pretty definitely resolved. At least, the Commission has decided as to various points that it has now expresed itself about. The Supreme Court has affirmed various positions the Commission has taken so that I do not see why we should have very lengthy briefs.

You have some points of law to discuss, of course, and I am not attempting to suggest what you shall include in your briefs or what you shall not but I simply say, to me this case seems to involve a few clear-cut principal issues, and, in view of that, I have accepted this commitment that the report of the Trial Examiner will be completed June 15 and if the briefs are to be of help to the Examiner, they must come in by the dates indicated.

Mr. Culton: Mr. Examiner, may I point out our difficulty. Of course, it is going to take, as you suggest, day [fol. 10749] and night work. We have no objection to that. We have done it in getting ready for these hearings and will continue to do it in the preparation of briefs. Although it will press us rather hard, we can meet the assignment of May 20 for the opening brief, but the thing that gives us concern is the June 1 date for reply briefs, bearing in mind we will have to reply to three separate and distinct briefs and we will not have their position until we get their briefs on May 20.

[fol. 10750] Mr. Littman: Mr. Examiner, I have a matter that I have omitted to take up. I would like to have marked for identification with the next exhibit number a document entitled, "Indiana Gas Distribution Corporation—Financial Statement for Year Ending December 31, 1941".

(The Document Referred To Was Marked Exhibit No. 266 For Identification.)

* * * * * * * *

[fol. 10751] (Exhibit No. 266 Was Received in Evidence.)

* * * * * * * * *

Trial Examiner: Have counsel for the Defendants any further testimony to present at this time?

Mr. Wheat: No, sir.

Mr. Littman: If Your Honor please, I would like to file with the Commission at this time and I do so by handing you herewith a copy of the instrument that I propose to file which is entitled, "Motion for an Immediate Order Reducing Rates".

I have nothing to present at this time.

Mr. Montgomery: Mr. Examiner, the Intervener wishes to file a motion with the Commission, a motion for an order reducing the rates of Defendants forthwith, pending any further investigation by the Commission, and I hand you [fol. 10752] copy of the original and five true copies.

In that connection, Mr. Examiner, we notice that in the last paragraph of our motion we set forth the fact that we still have in the course of preparation certain statistical data and analyses which counsel for the Respondents have very kindly consented to let us furnish them by not later than next Tuesday and it is our intention to file this data in the form of a supplemental motion, if it is agreeable to the Examiner.

Trial Examiner: I believe that may be permitted under the circumstances.

* * * * * * * * *

Mr. Wheat: Mr. Examiner, it is my understanding that the fixing of time for filing of briefs which you made this morning eliminates any necessity for formal replies to be

filed to these motions before the Commission. Is that correct?

Trial Examiner: That is true. We will take the record as it is closed today subject only to such enlargement of it as has been clearly placed in the record and the items which have been ruled to be filed after the conclusion must [fol. 10753] be filed at the time fixed. Otherwise, they will be disregarded as will briefs be if they are filed after the date set.

I will ask the reporter to extend into the record at this point first the petition of Commission counsel and next the petition of Michigan Consolidated Gas Company.

* * * * * * * *

[fol. 10768] Mr. Littman: I would like to make certain about one thing so that there may be no misunderstanding in the record.

[fol. 10769] It is my understanding that counsel for the Respondents have no further testimony to present on direct and have stated that they have no testimony to offer at this time with respect to the testimony which the Commission has thus far offered.

Now, that is my distinct understanding of the record at this point. Is that Your Honor's understanding and is that the understanding of counsel for the Respondents?

Mr. Culton: I may state in reply to that that I did not know that we were the moving parties in this proceeding and my understanding is that direct testimony means where you are the moving party. Now, so far as we are concerned, we are just like the old nigger I told about earlier—"We will 'drap' this whole thing right here."

Mr. Littman: Of course, the prima facie case was presented by the petitioner here and then Panhandle Eastern and Michigan Gas went on with their testimony. We want to give them every opportunity to present such testimony as they wish to present with respect to their case-in-chief.

Now, I see no occasion to be technical. I say "direct", I mean in their case-in-chief, and I would like to know whether they rest.

Mr. Culton: I should say, we are as near through as you are, Mr. Littman.

Mr. Wheat: We do not intend to be "druv into no more [fol. 10770] holes."

Mr. Littman: I am going to ask, in view of the statements of counsel, that the court reporter be instructed to state at this point in the transcript that counsel for Respondents rest.

Mr. Culton: We do not.

Mr. Littman: That is the clear purport, they either do or do not.

Mr. Culton: We will not let you tell us what we shall say.

Mr. Wheat: And we do not intend, if we can possibly avoid it, having the court reporter saying anything in this record that we have not said.

Mr. Littman: I do not propose to have or give counsel an opportunity to rely upon what I think they are endeavoring to rely upon as a technicality or a basis or claim that they have not had an opportunity to present their entire case-in-chief. We went forward with our evidence in order to expedite this hearing before they had put in all of their direct case.

Now, they either have put in all their direct case or they have not and I am inquiring whether they have put in their direct case-in-chief to the resting point or whether they have not and I am entitled to know.

Mr. Culton: Nil dicit.

Mr. Littman: This may seem very humorous to some [fol. 10771] present. It is not the least bit humorous to me.

Mr. Wheat: We have stated our position several times. It is perfectly clear on the record.

Mr. Littman: You have stated it in so many different ways that it can be construed by you almost any way you like to construe it in argument later and I certainly am not going to be charged later that I have failed in my duty with respect to at least undertaking to ascertain what your position is. I would like to have you be frank about it.

Have you or have you not had every opportunity up to this point to complete your case-in-chief?

Now, if you cannot give me a courteous answer to a courteous question I, of course, cannot force you to answer that but I want to give you an opportunity to do it.

Mr. Culton: We thought you thought you could, Mr. Littman.

Mr. Wheat: We believe, Mr. Examiner, that the record is clear on our position.

Mr. Littman: Why not be frank about this? What are we doing, trying to play on words?

Mr. Culton: That is what I have been wondering about you ever since you started.

Mr. Littman: Have you rested or haven't you rested?

Mr. Culton: We do not have to adopt your language on anything. We have just tried one side of this case.

Mr. Littman: I think I know what you are trying to do [fol. 10772] but you are not going to get away with it.

Trial Examiner: Now, the Trial Examiner might remark that recently in the record, to-wit, at page 10651, the question was put squarely to the attorneys representing the Panhandle Eastern Pipe Line Company and its subsidiaries whether they had any desire at this time to adduce any further evidence of any kind or character and they replied that they did not at this time "unless further evidence comes into the record which we feel should be properly rebutted."

Today an opportunity has been given to present rebuttal testimony.

Mr. Culton: And we said we had no further testimony to offer.

Trial Examiner: And you replied you had none to offer.

Mr. Culton: That is right.

Trial Examiner: And your statement of record on April 21, which was just quoted, still stands, I assume?

Mr. Culton: That is right.

Trial Examiner: The Trial Examiner construes that as being what some lawyers designate as a "rest".

Mr. Culton: It may be we got a little tired right there.

Trial Examiner: We will proceed accordingly.

Mr. Culton: Counsel is unduly alarmed, Mr. Examiner, as to what our intentions may be in the future.

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[fol. 10773] Trial Examiner: Well, I think Mr. Lit… concern is to be assured, both across the table and … record, that the Panhandle Eastern Pipe Line Co… and its subsidiaries have not at any time or in any m… been denied the requirements of due process in thi… ceeding.

Mr. Culton: That is right, Mr. Examiner, so far a… phase of it is concerned. We will not make the cont… that we have not had an opportunity to put on add… testimony here if we had so desired.

Trial Examiner: Of course, we wish to be sure th… have had every opportunity contemplated by the re… ments of due process.

Mr. Culton: There is this we would say. We w… make it clear we think fundamental error was commit… [fol. 10774] the Commission in overruling a petitio… postponement relating to Order 31 and relating to th… situation. We want to make it clear we do not waive… motions and we think the same condition now exist… existed at that time but we recognize that this Exa… has no power over that phase of the case.

Trial Examiner: All other matters having bee… posed of, this hearing will now adjourn without dat… ject to such further action as the Commission may… proper in the premises.

[fol. 10775] Exhibit 1

Panhandle Eastern Pipe Line Company
Michigan Gas Transmission Company

Operating Results
1938–1940

(000 Omitted)

	1938	1939	194…
Utility plant, cost			
less reserves	$	$	$
Dec. 31 of year	61,148	59,778	65…
Total, first and last of year		120,926	125…
Average during year	61,148.1	60,363	62…
Working capital	100	100	
Total	61,248	60,563	62…

Utility Operating Income	4,874	6,416
% Utility operating income of av. cost less reserves of utility plant plus working capital	7.96	10.59

Analysis of Depreciation Provision in Determination of Operating Income

Cost of utility plant		
Dec. 31 of year	68,173	69,151
Total first and last of year		137,326
Average during year	68,173(1)	68,662
Depreciation provision	2,159	2,393
% Depreciation provision	3.17	3.49

(1) End of year amount used in place of average

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[fol. 10777] Panhandle Eastern Pipe Line Company
Michigan Gas Transmission Company

Cost, and Cost Less Reserves, of Plant and Operating Resul[ts]
As of December 31, 1938

		A	B
1.	Utility plant	$58,044,047	$9,260,047
2.	Reserve for amortization of gas sales and purchase contracts	879,086	
3.	Total, cost new	58,923,133	9,260,047
4.	Construction work in progress	9,689	—
5.	Plant in service, cost new	58,913,444	9,260,047
6.	Reserves for		
	a. Depreciation of gas plant	4,895,485	787,284
	b. Amort. and depletion of gas plant	463,730	
	c. Amort. of gas sales and purchase contracts	879,086	
	d. Total reserves	6,238,301	787,284
7.	Cost new less reserves	52,675,143	8,472,763
8.	Utility operating income	4,261,497	609,105
9.	Depreciation	1,405,546	275,576(1)
10.	Depletion	151,448	
11.	Amort. Lim. Term Util. Inv.	326,893	
12.	Total	1,883,887	275,576

13.	Available for depreciation depletion, amortization and return	$6,148,382	884,681	7,033,063

A. Panhandle Eastern Pipe Line Co.
B. Michigan Gas Transmission Co.

Source: Annual Reports to Federal Power Commission.

(1) Designated as Provision for Retirement.

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[fol. 10778] Panhandle Eastern Pipe Line Company
Michigan Gas Transmission Company

Cost, and Cost Less Reserves, of Plant and Operating Results
As of December 31, 1939

		A	B	Total
1.	Utility plant	$58,632,902	$9,812,436	$68,445,338
2.	Reserve for amortization of gas sales and purchase contracts	1,172,114	—	1,172,114
3.	Total, cost new	59,805,016	9,812,436	69,617,452
4.	Construction work in progress	466,042	—	466,042
5.	Plant in service, cost new	59,338,974	9,812,436	69,151,410
6.	Reserve for			
	a. Depreciation of gas plant	6,526,415	1,057,725	7,584,140
	b. Amort. and depletion of gas plant	616,686	—	616,686
	c. Amort. of gas sales and purchase contracts	1,172,114	—	1,172,114
	d. Total reserves	8,315,215	1,057,725	9,372,940
7.	Cost new less reserves	51,023,759	8,754,711	59,778,470
8.	Utility operating income	5,490,019	925,636	6,415,655
9.	Depreciation	1,627,943	276,421 (1)	1,904,364
10.	Depletion	159,317	—	159,317
11.	Amort. Lim. Term Util. Inv.	329,300	—	329,300
12.	Total	2,116,560	276,421	2,392,981
13.	Available for depreciation, depletion, amortization and return	7,606,579	1,202,057	8,808,636

A. Panhandle Eastern Pipe Line Co.
B. Michigan Gas Transmission Co.

Source: Annual Reports to Federal Power Commission.

(1) Designated as Provision for Retirement.

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[fol. 10779] Panhandle Eastern Pipe Line Company
Michigan Gas Transmission Company

Cost, and Cost Less Reserves, of Plant and Operating Results
As of December 31, 1940

		A.	B.	Total
1.	Utility plant	$63,654,119	$12,295,897	$75,950,016
2.	Reserve for amortization of gas sales and purchase contracts	1,465,143	—	1,465,143
3.	Total, cost new	65,119,262	12,295,897	77,415,159
4.	Construction work in progress	673,905	5,076	678,981
5.	Plant in service, cost new	64,445,357	12,290,821	76,736,178
6.	Reserves for			
	a. Depreciation of gas plant	7,942,316	1,339,273	9,281,589
	b. Amort. and depletion of gas plant	710,545	—	710,545
	c. Amort. of gas sales and purchase contracts	1,465,143	—	1,465,143
	d. Total reserves	10,118,004	1,339,273	11,457,277
7	Cost new less reserves	54,327,353	10,951,548	65,278,901
8.	Utility operating income	5,541,004	911,964	6,452,968
9.	Depreciation	1,636,745	292,767 (1)	1,929,512
10.	Depletion	160,145	—	160,145
11.	Amort. Lim. Term Util. Inv.	329,110	—	329,110
12.	Total	2,126,000	292,767	2,418,767
13.	Available for depreciation, depletion, amortization and return	7,667,004	1,204,731	8,871,735

A. Panhandle Eastern Pipe Line Co.
B. Michigan Gas Transmission Co.

Source: Annual Reports to Federal Power Commission.

(1) Designated as Provision for Retirement.

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[fol. 10780]

Panhandle Eastern Pipe Line Company
Michigan Gas Transmission Company

Working Capital Estimate
Dec. 31, 1938-39-40

	Current and Accrued Assets	Current and Accrued Liabilities	Working capital	Adj. for increased cash	Operating working capital
1938					
Panhandle Eastern Pipe Line Co.	$2,532,852	$3,682,912			
Michigan Gas Transmission Co.	1,058,606	867,559			
Total	3,591,458	4,550,471	($ 959,013)	0	($969,013)
1939					
Panhandle Eastern Pipe Line Co.	6,674,561	2,064,074			
Mich. Gas Transmission Co.	1,443,490	1,025,000			
Total	8,118,051	3,089,074	5,028,977	4,242,008	786,969
1940					
Panhandle Eastern Pipe Line Co.	4,980,241	3,102,279			
Mich. Gas Transmission Co.	2,111,709	1,543,607			
Total	7,091,950	4,645,886	2,346,064	2,901,777	(555,713)

Cash	1938	1939	1940
Panhandle Eastern Pipe Line Co.	1,179,681	5,179,508	3,300,678
Mich. Gas Transmission Co.	181,206	423,387	961,986
Total	1,360,887	5,602,895	4,262,664
Increase above 1938	—	4,242,008	2,901,777

The adjustment is made on the assumption that the increased cash in 1939 and 1940 was required to meet construction programs.

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[fol. 10782] Panhandle Eastern Pipe Line Company

Michigan Gas Transmission Company

Working Capital Estimate
Approximate Payroll Basis
Dec. 31, 1940

	Panhandle Eastern Pipe Line Co.	Michigan Gas Transmission Co.	Total
Natural Gas Production			
Operation	$ 84,128		$ 84,128
Maintenance	22,182		22,182
Gasoline plant operation and maintenance	Not available		
Transmission			
Operation	474,152(1)	$ 62,820(3)	539,672
Maintenance	211,985	54,901	266,886
Customer's acct. and collecting	13,672		13,672
Sales promotion expense	11,754	4,020	15,774
Administrative and general	287,792(2)	42,045(4)	329,837
Total, year	1,105,665	163,786	1,269,451
Monthly average			105,787

(1) $981,462 less 3,170,695 M. cu. ft. of gas at 16¢, or $507,310 leaving $474,152.
(2) Taken at 1/2 of $575,584 on assumption that insurance, injuries and damages, etc., comprise an equal part of the account.
(3) $172,397 less company use gas of $109,577 or $62,820.
(4) One-half of $84,090 for reasons stated in (2).

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[fol. 10783]

Exhibit 2

Panhandle Eastern Pipe Line Company
Michigan Gas Transmission Company

Determination of Possible Revenue Reduction
(000 Omitted)

			1938	1939	1940
1.	Cost of utility plant Av. during year		$68,173(1)	$68,662	$72,944
2.	Working capital		100	100	100
	Total		68,273	68,762	73,044
4.	Available for depreciation, depletion, amortization and return		7,033	8,809	8,872
5.	Percent of Line 3		10.30	12.82	12.15
	Annual requirement for depreciation, depletion, amortization of and return on utility plant (Note 1).				
	Annual rate of return	Requirement			
	5%	6.51%	4,438	4,470	4,749
	6	7.26	4,949	4,985	5,296
	7	8.26	5,495	5,534	5,879
	8	8.88	6,054	6,097	6,477
	Return requirement on working capital at				
	5% per annum		5	5	5
	6 " "		6	6	6
	7 " "		7	7	7
	8 " "		8	8	8
	Total requirement at				
	5% per annum return		4,443	4,475	4,754
	6 " " "		4,955	4,991	5,302
	7 " " "		5,502	5,541	5,886
	8 " " "		6,062	6,105	6,485
	Excess of amount available over requirement for				
	5% per annum return		2,590	4,334	4,118
	6 " " "		2,078	3,818	3,570
	7 " " "		1,531	3,268	2,986
	8 " " "		979	2,704	2,387

Note 1. 1940 Estimate of life of gas supply 25 yrs.
1940 Age of property, 1940-1932 8 "
Total life 33 "

To allow for shorter life of additions since 1932 and for 10-year life being used for gas sales and purchase contracts a life of 30 years will be used in determining depreciation, depletion, amortization and return requirements.

MKT 7-15-41
2 Corrected 7-18-41

Extracts from Registration Statement
of Panhandle Eastern Pipe Line Co.
Filed with Securities and Exchange Commission
Feb. 12, 1937 in File No. 2-2867-1-1
3 In re: Gas Reserves

The Issuer now owns or controls oil and gas leaseholds on approximately 207,800 acres of land, in the Panhandle of Texas, Southwestern Kansas and Texas County, Oklahoma, and in addition controls through gas purchase contracts approximately 44,500 acres of land in this territory. A part of the Issuer's gas supply is obtained from wells heretofore drilled on certain of these leaseholds, the remainder being purchased under contracts, either for the life of commercial production on the leases or for a fixed term, varying from eight to sixteen years, with other producers, in the same general territory.

In the opinion of Ralph E. Davis, Inc., consulting geologists and engineers, the combined reserves of the entire Amarillo and Hugoton fields, from which fields the Issuer obtains its supply of gas, are estimated as of February 1, 1937 at approximately 30 trillion cubic feet; it is estimated that gas is being produced in these two fields at the rate of approximately 665 billion cubic feet per year and that this rate of production will be increased considerably; the gas reserves which the Issuer itself controls under leases and gas purchase contracts in these two fields are estimated at approximately 1,874 billion cubic feet, and its delivery requirements, which have increased to a present annual total of approximately 20 billion cubic feet, are expected hereafter to increase as the demand for natural gas increases in the territory which it serves; during the past few years, there has been considerable wastage of the natural gas produced in the Amarillo field; in 1935 the State of Texas enacted a conservation statute which resulted in a substantial reduction of the gas wastage; the statute was attacked by two of the pipe line companies operating out of the Amarillo field, and on February 1, 1937, the Supreme Court of the United States held it to be unconstitutional insofar as it might be construed to permit certain proration orders entered by the Texas Railroad Commission; (*Thompson, et al. v. Consolidated Utilities Company*, No. 89, October Term, 1936); whatever the immediate effect of this decision may be it is probable that the normal operation of economic factors will prevent any gas wastage on a large scale for more than a limited period of time in the future; and after giving consideration to all of the known factors affecting the future supply and probable demand, the Issuer will be able to obtain supplies of natural gas sufficient for its market requirements for a period of not less than twenty-five years.

In the opinion of counsel, the natural gas transmission line operated by the Issuer and its subsidiary, Panhandle Illinois Pipe Line Company, which extends from the Texas Panhandle gas field through the states of Oklahoma, Kansas, Missouri and Illinois to a point near Dana, in Vermillion County, Indiana, is owned by the Issuer and said subsidiary, subject to certain mortgages hereinafter referred to, to farm mortgages on land covered by leases and rights of way owned by the Issuer, to which the Issuer is not a party, and to minor encumbrances and defects in title.

The main pipe line of the Issuer's transmission system, extending, as described in the preceding paragraph, from the Texas Panhandle gas field to Indiana, and so owned by the Issuer and its subsidiary, Panhandle Illinois Pipe Line Company, consists of approximately 351 miles of 24-inch diameter pipe line, 450 miles of 22-inch diameter pipe line, 58 miles of 20-inch diameter pipe line, and an aggregate of 43,300 horse power of gas engine driven compressor units installed in 10 stations.

In addition, meter stations, a dehydrating plant, a natural gasoline extraction plant, and other equipment and property used in the operation and maintenance of a high-pressure gas transmission system, are owned by the Issuer or its subsidiary companies.

In the opinion of The J. G. White Engineering Corporation the Issuer's main transmission system, as originally constructed, including pipe lines, compressor stations, and field and lateral lines, together with all other physical facilities, is of modern design and well constructed, operated and maintained, and the construction of its new transmission facilities reflects sound engineering practice and includes the latest available technical develop-

4021

RALPH E. DAVIS, INC.
ENGINEERS
Petroleum and Natural Gas
1710 Union Bank Building
Pittsburgh

New York
150 Broadway

November twelfth,
Nineteen forty.

Board of Directors,
Panhandle Eastern Pipe Line Company,
New York, New York.

EXHIBIT 4.

Gentlemen:

In accordance with your request, we have made a study as of September 30, 1940 of the natural gas supply available to your company. The gas produced and purchased by your company and the gas reserves available to it are located almost entirely in the Amarillo field of Texas and in the Hugoton field which includes portions of (a) southwestern Kansas, (b) the Oklahoma Panhandle, and (c) Sherman and Hansford Counties in northwest Texas. These fields together constitute one of the largest known reserves of natural gas.

The conclusions stated herein regarding the reserves of these fields are based upon engineering and geological studies we have made of both of these fields since they each became important as a source of supply of natural gas, including information made available to us in former detailed studies of your company's gas supply, and upon a recent study of both the Amarillo and Hugoton fields. Data regarding acreage controlled, wells owned or under gas purchase contracts, production of these wells and their pressure history have been furnished by officials of Panhandle Eastern Pipe Line Company.

Our most recent study of the Amarillo field indicates that the proven gas acreage covers an area of approximately 1,478,000 acres and that the recoverable gas reserves as of September 30, 1940 are not less than 17.0 trillion cubic feet. Your company owned on September 30, 1940 leases covering a total of 42,136 acres in the proven area of this field, this being approximately 2.85 per cent of the total proven area. Upon these lands there had been completed as of said date a total of 55 wells, 11 of which were completed subsequent to July 1939. The average closed pressure of 40 of these wells in June 1937 was 378.9 pounds. The closed pressure in July 1940 of these 55 wells was 358.9 pounds indicating an average pressure drop of 20.0 pounds in a three-year period. The production of these wells from January 23, 1937 to September 22, 1940, a period of 3 years and 8 months, totaled 55,093,000 M cubic feet or an average production of more than 2 billion cubic feet per pound drop in pressure.

Your company owned gas purchase contracts as of September 30, 1940 covering 23,393 acres in the proven area of the Amarillo field upon which there had been completed a total of 53 wells. Thirty-eight of these wells had an average pressure in June 1937 of 311 pounds and the average of the 53 wells in June 1940 was 308 pounds. During the period from January 23, 1937 to September 22, 1940 these wells had delivered a total of 49,908,000 M cubic feet.

It is evident from the very substantial production obtained with a modest decline in pressure that the acreage upon which your company controls its gas supply in the Amarillo field has a very substantial productive capacity. The total proven acreage controlled through leasehold and through gas purchase contracts, namely 65,529 acres, is equal to about 4.43 per cent of the total proven area of the Amarillo field. It is our judgment that your company thus controls approximately this percentage of the total recoverable reserve, that is, approximately 750 billion cubic feet. A

Of the company-owned leases held on September 30, 1940 covering a total of 42,136.30 acres of proven gas lands in the Amarillo field, 30,005.7 acres are classed as producing acreage, having a proven gas reserve which we estimate at 361,769,000 M cubic feet. The remaining owned proven leaseholds, totalling 12,130.6 acres are classed as unoperated, and have an estimated gas reserve which we estimate at 146,254,000 M cubic feet. The gas purchase contracts owned by your company September 30, 1940, covering gas purchases in the Amarillo field, control the gas under 23,393 proven acres, all classed as operated and having a proven reserve which we estimate at [illegible] B

Extract from Registration Statement
of Panhandle Eastern Pipe Line Co.
Filed with Securities and Exchange Commission
Nov. 15, 1940 in File No. 2-4579-1-1
In re: Gas Reserves

4a

Our most recent study of the Hugoton field indicates the proven and semi-proven area to be not less than 2,000,000 acres and the total recoverable gas reserve as of December 31, 1939 to be not less than 15 trillion cubic feet. In the proven or semi-proven portion of this field your company owns full-interest leases covering 175,030 acres, also one-half interest in an additional 18,428 acres. The gas supply from the unowned one-half interest is under contract to your company, hence the reserves under 193,458 acres are thus controlled.

Your company owned as of September 30, 1940, 33 wells on its wholly-owned Hugoton leasehold acreage. The average pressure of 26 of these wells in June 1937 was 421 pounds and the average pressure of the 33 wells in July 1940 was 414 pounds. During the period from January 23, 1937 to September 22, 1940, these wells produced 11,384,000 M cubic feet.

On September 30, 1940 there had been completed 34 wells on the 18,428 acres in which your company owned one-half interest. Twenty-four of these wells had an average pressure in June 1937 of 415 pounds and the 34 wells had an average pressure in July 1940 of 411 pounds. During the period January 23, 1937 to September 22, 1940 these wells produced a total of 11,876,000 M cubic feet.

The company-owned full-interest leases covering a total of 175,030.25 acres in the proven or semi-proven portion of the Hugoton field, include 19,090.95 acres classed as operated, and have a proven gas reserve estimated by us at 126,189,000 M cubic feet. C The remaining 155,939.30 acres of full-interest leases are classed as unoperated, and have gas reserves estimated by us at 1,030,739,000 M cubic feet. D

The fifty per cent interest owned by your company in 18,428 acres of proven or semi-proven leasehold property includes a total of 17,320 acres classed as operated, and have a gas reserve estimated by us at 114,483,000 M cubic feet. E The remaining 1,108 acres are classed as unoperated and have an estimated gas reserve of 7,324,000 M cubic feet. F

Your company owned on September 30, 1940 gas purchase contracts controlling 33,475 acres in the Hugoton field upon which there had been completed 68 gas wells. Fifty of these wells had an average pressure in June 1937 of 420 pounds and 67 wells had an average pressure in July 1940 of 415 pounds. These wells produced during the period January 23, 1937 to September 30, 1940 a total of 24,919,000 M cubic feet. These 33,475 acres are classed as operated and have a proven reserve which we estimate at 221,265,000 M cubic feet. G

The total proven or semi-proven acreage controlled by your company in the Hugoton field through leasehold and gas purchase contracts on September 30, 1940 was 226,933 acres. This is more than 10 per cent of the total proven and semi-proven area as now defined. It is our judgment that your company thus controls gas reserves as of September 30, 1940 in the Hugoton field of not less than 10 per cent of the total reserve of said field, that is, not less than 1.5 trillion cubic feet.

Both the Amarillo and Hugoton fields constitute reservoirs of gas from which gas withdrawals will not necessarily be proportional to the reserves controlled by various producers. The reserves are, we believe, sufficient to meet the combined anticipated requirements for pipe line, carbon black and other uses for a period of more than 25 years.

The combined gas supply controlled by your company in the Amarillo and Hugoton fields is, in our judgment, adequate to supply its present markets and any reasonably anticipated increase in the gas requirements of said markets for a period of more than 25 years.

Very truly yours,

RALPH E. DAVIS, INC.,

by Ralph E. Davis,
President

The Registrant also owns oil and gas leaseholds on (a) certain acreage outside proven limits of the Amarillo and Hugoton fields and (b) approximately 1,100 acres on which is located one well and a half interest in approximately 10,000 acres on which are located twelve wells in the Hugoton field the gas from which is sold under contract to the Argus Natural Gas Company, Incorporated.

[fol. 10788]

Exhibit 4-B.

Summary of Statement re Natural Gas Reserves
of Panhandle Eastern Pipe Line Company,

by Ralph E. Davis, President of Ralph E. Davis, Inc.

(Page 17, 18 of Registration Statement
Filed Nov. 13, 1940 in File 2-4579-1-1)

Amarillo Field			
A.	Contracts		750,000,000 M. cu. ft.
B.	Owned Leases		241,977,000 " " "
			991,977,000
Hugoton Field			
C.	Leases, Wholly-owned		126,189,000
D.	" "	(1)	1,030,739,000
E.	Leases, Jointly-owned		114,483,000
F.	" "	(1)	7,324,000
G.	Contracts		221,265,000
			1,500,000,000
	Grand Total		2,491,977,000 M. cu. ft.
	100% Leased Factor Annual Capacity of Pipe Line		91,250,000 " " "
	Probable Life of Supply		27.4 yrs.

(1) Unoperated at date of registration statement.

MKT 7-11-41
4b

EXHIBIT 5

Extracts from Registration Statement of Panhandle Eastern Pipe Line Co. Filed with Securities and Exchange Commission Nov. 13, 1940 in File No. 2-4579-1-1 In re: Design, Construction and Maintenance of Property

pipe lines, in-
ding multiple lines, owned by the Registrant and by Illinois Natural Gas Company,
of September 30, 1940

Nominal diameter inches	Main transmission lines	Branch or lateral lines	Gathering and well lines
24	733	—	—
22	534	—	—
20	83	—	8
18	72	—	13
16	39	68	35
12	10	53	25
10	33	52	76
Various Sizes 8 to 2	—	386	512
Total	1,504(1)	559(2)	[illegible]

(1) Includes 82 miles of 24" and 24 miles of 20" pipe line under construction at September 30, 1940 which are scheduled for completion prior to December 31, 1940.

(2) Includes 68 miles of 16", 32 miles of 12", 37 miles of 10", and 87 miles of various sizes from 8" to 2" pipe line owned by Illinois Natural Gas Company.

Lines owned by Central Distributing Company are used for retail distribution of
al gas as set forth in Item 5, and are not included in the foregoing table.

The Registrant owned the following compressor stations, as of September 30, 1940

Station	Total rated horsepower
Sneed	5,200(1)
Hansford	3,500(2)
Liberal	10,000(3)
Greensburg	7,800
Haven	7,800
Olpe	7,800
Louisburg	7,000
Houstonia	6,500
Centralia	6,500
Pleasant Hill	6,500
Glenarm	6,000
Tuscola	5,100
Three small stations	860
Total	80,960

(1) Of the 5,200 total rated horsepower at Sneed Station, 1,300 was under construction at September 30, 1940 and is scheduled for completion prior to December 31, 1950.

(2) This station was under construction at September 30, 1940, and is scheduled for completion prior to December 31, 1940.

(3) The Registrant's natural gasoline extraction plant and this compressor station are located on the same site.

P. McDonald Biddison, consulting engineer, Dallas, Texas, has made an examina-
n of the properties of the Registrant and its subsidiaries and submitted a letter
ereon. Such letter follows:

P. McDONALD BIDDISON
CONSULTING ENGINEER
Dallas Gas Building
Dallas, Texas

November 2, 1940

oard of Directors
anhandle Eastern Pipe Line Company
entlemen:

On several occasions beginning in March 1937, I have been engaged in studies and
vestigations of the business and properties of your company and of its Subsidiary
ompanies. These studies and investigations have included the reviewing of construc-
on plans, determining safe operating pressures and system capacities, the prepara-
on of property valuations, and studies of property depreciation.

I have examined a great deal of the property and have inspected plans and specifications under which it was constructed. The Company owns or controls under purchase contracts, gas reserves in the largest gas fields ever known, adequate, for the requirements now in prospect, for a term of at least twenty-five years. The compressor stations on the main system are carefully designed, their equipment is first class in all respects, they present a neat and attractive appearance and are maintained in excellent condition. All these features tend to produce reliability and economy of operation. The main transmission system has been constructed with a margin of safety as to pressure so that it may safely be operated at 500 pounds compressor station discharge pressure. Stream crossing locations have been carefully selected and multiple lines across streams so located and installed as to leave very slight probability of interruption at such locations. The transmission lines have been well located and well laid to secure stability and are carefully maintained. The main line loops completed in 1937 provide additional protection against service interruption and this protection will be enhanced by the loop extensions recently completed and by those now under construction. The Gasoline Plant at Liberal is of modern design and the dehydration plant in connection with it is an effective preventive of interruptions of service from freezing of lines. Measuring and Regulating Stations are of up to date equipment, are carefully maintained and the stations are neat and clean. Little evidence of deterioration in the main line property can be found. Pipe exposed in making connections for 1937 and 1940 additions did not indicate interior corrosion. Flow tests of the main lines in 1937 and 1938 showed some fouling, not corrosion, of the old lines westward from Olpe Station to Liberal Station. This condition has been effectively remedied as evidenced by subsequent flow tests and by capacity obtained under routine operations. Routine reports show little deterioration of protective coating and pitting of pipe except in a few very restricted areas. Such areas are being protected cathodically as they develop.

My studies of the system's capacity indicated a sales capacity of the main line system, including the deliveries at Dana and with the distribution of the deliveries west of Dana as they then existed, prior to the loop extensions of the 1940 construction program, to be in round numbers 200,000 M.C.F. per 24 hours, all of which capacity was used to render service during the past winter. Upon completion of the extensions of the loops by the 1940 construction program, now over 95 per cent completed, the corresponding capacity will be, in round numbers, 250,000 M.C.F. per 24 hours. Facilities for the delivery of this peak load will be fully adequate upon the completion of field compressor station construction now in progress and scheduled for completion prior to December 31, 1940.

Yours very truly,

P. McDONALD BIDDISON
Consulting Engineer

Character of Ownership

The statements in answer to this Item 7 with respect to ownership are made upon the authority of Glenn W. Clark, Esq., head of the Registrant's legal department. In his opinion, based in part upon opinions of various local counsel, the above mentioned production property and transmission property are owned by the Registrant or by its wholly owned subsidiary (Illinois Natural Gas Company) as indicated above, subject to certain mortgages hereinafter described, to farm mortgages (to which neither the Registrant nor Illinois Natural Gas Company is a party) on land covered by leases and rights-of-way owned by the Registrant and Illinois Natural Gas Company, and to minor encumbrances and defects in title. The compressor stations mentioned are located on land owned in fee by the Registrant. The pipe lines of the Registrant and Illinois Natural Gas Company are located either (1) under or over rivers, highways and other public places under permits referred to in Item 8 hereof, or (2) under or over private property by virtue of rights-of-way or easements obtained from the persons who, at the time such rights-of-way or easements were obtained, were the last grantees of record of the fee title to the land involved. Substantially all the pipe lines of the Registrant and of such subsidiary are located on lands over which rights-of-way or easements have been secured and at the time such rights-of-way or easements were secured inquiry was made as to the existence of farm mortgages upon the lands covered thereby and in many instances agreements were obtained from mortgagees sub-

[fol. 10791]

Exhibit 6

Panhandle Eastern Pipe Line Company
Michigan Gas Transmission Company

Operating Expenses and Taxes at 100% Load Factor Operation

	P.E.P.L.Co.	M.G.T.Co.	Total	Factor	100% Load Factor Operation
Natural gas production expense					
Operation	$84,128	$	$ 84,128	1.000	84,000
Maintenance	22,182		22,182	1.000	22,000
Gas well royalties	143,342		143,342	1.686	242,000
Rental on non-oper. leases	101,344		101,344	1.000	101,000
Net credit for residuals pro.	166,233		166,233	1.343(4)	223,000
Total natural gas production	184,763		184,763	—	226,000
Credit for gas used	616,610	76,692(2)	693,302	1.686	1,169,000
Total	(431,847)	(76,692)	(508,539)	—	(943,000)
Gas purchased	1,118,861	(1)	1,118,861	1.686	1,886,000
Total gas production expense	687,014	(76,692)	610,322	—	943,000
Transmission expense					
Gas	498,116	76,692(2)	574,808	1.686	969,000
Operation Other	483,346	62,822	546,168	1.000	546,000
Maintenance	211,985	54,901	266,886	1.000	267,000
Rents	—	2,615	2,615	1.000	3,000
Total transmission expense	1,193,497	197,030	1,390,477	—	1,788,000
Customers' acct. & coll. exp.	13,673	—	13,673	1.000	14,000
Sales promotion expense	11,754	4,019	15,773	1.686	27,000
Administrative or general exp.	575,584	84,090	659,674	1.000	660,000
Total	2,481,472	208,300	2,689,919	—	3,432,000
Taxes	2,536,788	492,741	3,029,529	1.000	3,030,000
Total	5,018,260	701,041	5,719,448	—	6,462,000

(1) $2,596,406 omitted to avoid duplication.
(2) Less $109,575 for 489,110 M cu. ft. gas used in operation, P. E. P. L. Co: figure of $616,610 for 3,932,527 M cu. ft. or 15.68¢ per M cu. ft. This represents a cost of $76,692, which is included as credit for gas used.
(3) Annual capacity at 100% load factor, 250,000x365 equals 91,250,000 M cu. ft.
1940 deliveries to mains 54,116,525 M cu. ft.
Ratio 1.686
(4) Only one-half of increase volume ratio used to allow for increased cost of residual production.

MKT 7-7-41

Corrected 7-18-41

[fol. 10793] Exhibit 7

Panhandle Eastern Pipe Line Company
Michigan Gas Transmission Company

Necessary Price per M cu. ft. at 100% Load Factor
(000 Omitted)

Operating costs and taxes	$6,462
Depreciation, depletion, amortization and return	
Requirements for	
5% per annum return	4,754
6% " " "	5,302
7% " " "	5,886
8% " " "	6,485
Revenue requirements for	
5% per annum return	11,216
6% " " "	11,764
7% " " "	12,348
8% " " "	12,947
Necessary price per M cu. ft. on basis of 91,250,000 M cu. ft. per year for	
5% per annum return	0.123
6% " " "	0.129
7% " " "	0.136
8% " " "	0.142

MKT 7-15-41
Corrected 7-18-41
7

[fol. 10795] Exhibit 8.

Panhandle Eastern Pipe Line Company
Michigan Gas Transmission Company

Effect of 100% Load Factor on Earning Power of System

At 100% Load Factor the Michigan Consolidated Gas Company rate results in the following charge per therm:

12x$0.38 per therm annual demand charge	$ 4.56
365x$0.015 commodity charge	5.475
or a total cost for 365 therms of	$10.035
which is at the rate of	$0.0275 per therm

and with 1,055 BTU per cu. ft. gas the gate rate is

$\frac{100,000}{1,055}$ x $0.0275, or $0.26 per M cu. ft.

A 100% load factor and 250,000 M cu. ft. per day capacity provide a load of 91,250,000 M cu. ft. per year. At 25¢ per M cu. ft. this will produce a revenue of $23,725,-000. After deducting operating expenses and taxes (taxes not adjusted for increased income taxes and excess profit taxes from such revenue) of $6,473,000 there would remain $17,252,000 for depreciation, depletion, amortization and return on the average cost new during 1940 of $73,-044,000, or at the rate of 23.6% per year.

[fol. 10796] Exhibit 9.

Factors Affecting the Nature and Magnitude of Reported Net Incomes

The net income or net operating income disclosed on the income statement of any company will depend on the manner of accounting for costs resulting from the "risks" previously referred to. If these costs are classified as operating expenses, relatively low net incomes or net operating incomes will appear on the income statement. If they are classified as deductions from income or appropriations of surplus, a larger net income will be shown. Before determining the rate of return applicable to an enterprise it is therefore necessary to determine the accounting treatment prevailing with respect to costs resulting from risks. There are certain particular costs with respect to which there still is substantial variation in practice as between companies and which therefore have a particular significance with respect to the relative magnitudes of income shown on income statements. These points are:

(1) The extent to which losses of various kinds are provided for through the purchase of insurance, through self-insurance reserves or by inclusion, when incurred, in current operating costs.

(2) The specific point of transition from the classification of costs as operating costs to capital costs. This involves primarily the distinction between repairs charged

directly as current operating costs and repairs involving replacement in kind charged through the depreciation reserve account. It also involves the use of more substantial, and usually more expensive, construction in place of cheaper construction subject to greater maintenance, repair and physical depreciation charges.

[fol. 10797] (3) The specific character of the depreciation accounting practices. Particularly the extent to which current depreciation charges reflect wear and tear, rot and decay, inadequacy, obsolescence, changes in the art, storms, floods and other disasters, and the requirements of civil authorities.

(4) The extent to which the cost of changes resulting from requirements of civil authorities are compensated for by specific payments.

(5) The extent to which infrequently recurring costs resulting from unforeseen retirements, i. e., from storm, flood, and similar disasters or unforeseen developments in the art or changes in public demand have been included either in (a) current operating costs, (b) provided for out of current or accrued surplus, or (c) guarded against by more substantial construction.

(6) The extent to which improvements in the art are acquired, either (a) by the conduct of a research department, the costs of which are included either in (1) the current operating costs, or (2) in the cost of fixed capital items, or (b) by the acquisition of patents from others, the costs of which are included either in (1) the current operating costs, or (2) in the cost of fixed capital items.

(7) The extent to which management costs, in many forms of investments necessarily met out of returns, are included in current operating costs.

(8) The nature and magnitude of risks peculiar and individual to the natural gas industry as conducted by the companies under discussion but not included in the preceding list and not common to all the business of the Nation as a whole. Among these would be the risk that,

during periods of prosperity natural gas use and profits would not increase as rapidly as business and business profits generally, and that during periods of depression the gas business and profits would decrease more rapidly than business and business profits generally. Conversely, this could be a benefit if the gas business and profits increased more rapidly during business prosperity and did not decrease as fast or as far during depression periods. In this class would also come the variation in probability of supersession by other means of heat energy supply as compared with the general probability of supersession of [fol. 10798] other tools of enterprise. (This, of course, relates only to that portion of the risk not previously provided for in (5) and (6) in connection with obsolescence and similar provisions.

(9) The relation between the price level at which a cost was incurred, the probable price levels at which various parts of the cost will be recovered, the price levels of other commodities at the same instances and the particular point during the investment period at which the rate of return under discussion is to apply.

(10) As between enterprises the practice differs with respect to the accounting treatment of bad debts. If a net income is calculated on the basis of total sales or billings without adjustment for uncollectible bills or bad debts, the costs incident to the incurrence of these must be met out of the income. On the other hand, if the income is determined on the basis of actual cash receipts or after allowance for bad debts in operating expenses, the reported income is exclusive of this risk and lower than it would be under the first condition.

(11) Certain investments, particularly state and government bonds, are partly or entirely exempt from taxation. In making comparisons between the returns on securities of this kind with returns on other investments, this factor must be properly reflected.

MKT 5-7-41

[fol. 10799]

Exhibit 10

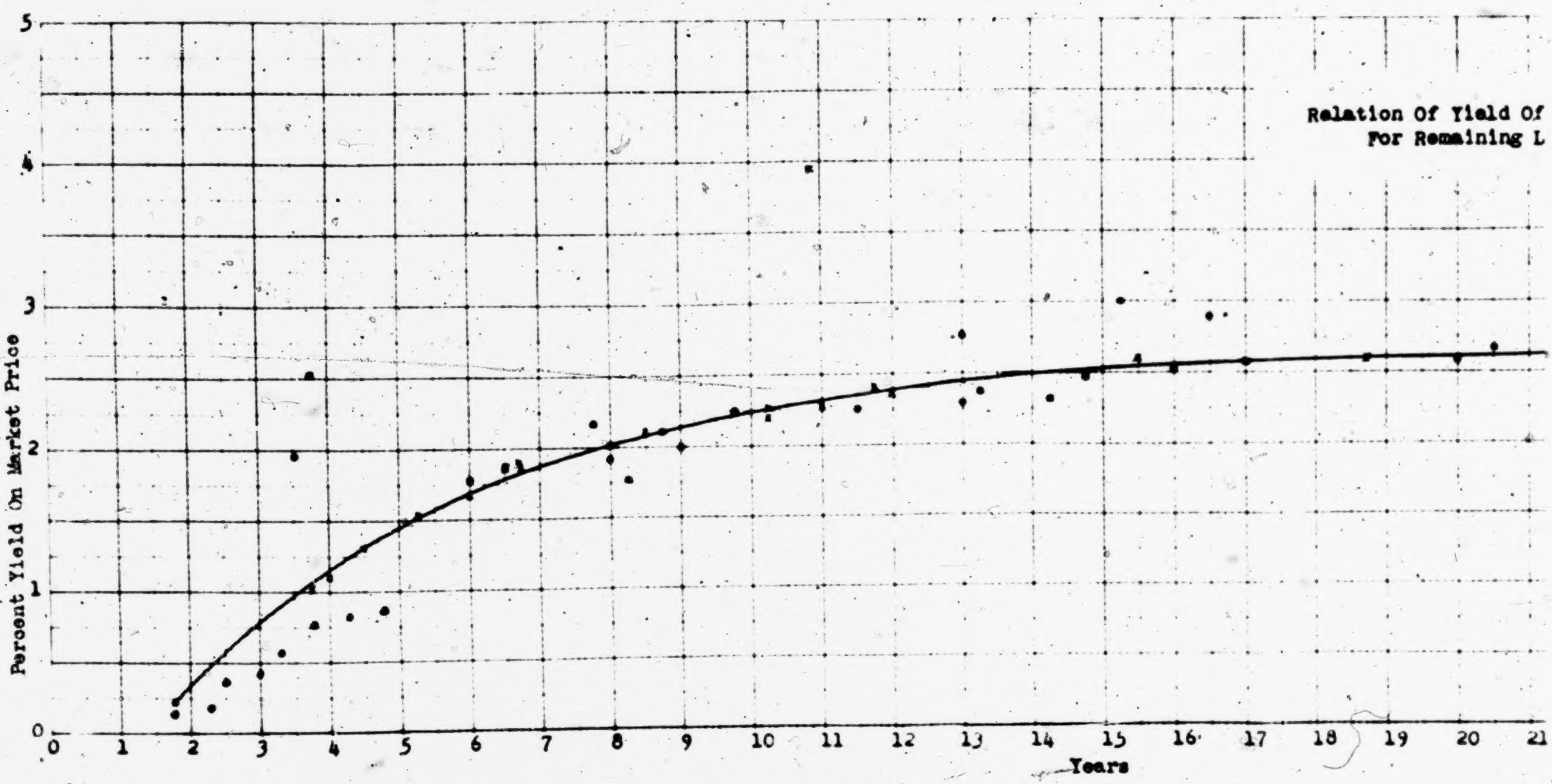
Panhandle Eastern Pipe Line Company
Michigan Gas Transmission Company

Effect Of Variation In Accounting Practices
On Reported Incomes Of An Enterprise

	Plan A		Plan B	
Net Investment	$100,000		$100,000	
Revenues, per Annum		$30,000		$30,000
Materials & Wages	20,000		20,000	
Insurance, etc.	——		5,000	
Total Operating Expense		20,000		25,000
Gross Income		10,000		5,000
% Gross Income		10		5
Deduction from Gross Income account of injuries, damages, fires and other losses	5,000			
Net Income	5,000		5,000	
% Net Income	5		5	

MKT 7-10-41

B



Relation Of Yield Of
For Remaining L
Percent Yield On Market Price
Years
0
1
2
3
4
5
6
7
8
9
10
11
12
13
14
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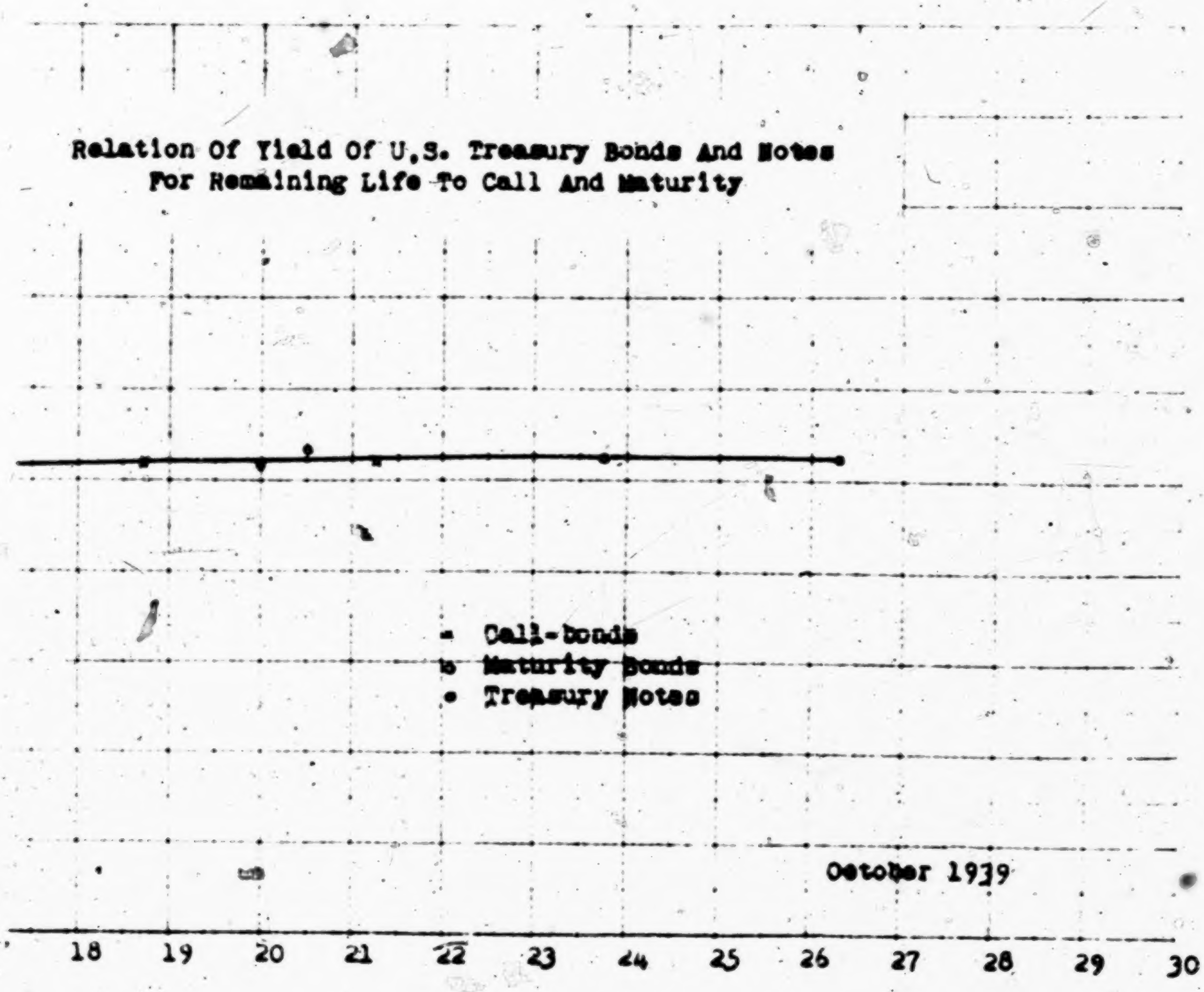
EXHIBIT 11


Relation Of Yield Of U.S. Treasury Bonds And Notes
For Remaining Life To Call And Maturity
- Call-bonds
Maturity Bonds
Treasury Notes
October 1939
18
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[fol. 10801] Exhibit 12

United States Treasury Bonds
Yields and Years to Call Date

(Based on Data in July 6, 1941 New York Times)

Issue			Yield to Call	Years to Call Date
3-1/4s	1941	(Aug. 1)	—	0.06
3-3/8s	1947-43	(June 15)	0.12	0.94
3-1/4s	1945-43	(Oct. 15)	0.19	2.28
3-1/4s	1946-44	(April 15)	0.33	2.78
4s	1954-44	(Dec. 15)	0.55	3.44
2-3/4s	1947-45	(Sept. 15)	0.67	4.19
2-1/2s	1945	(Dec. 15)	0.63	4.44
3-3/4s	1955-46	(March 15)	0.87	4.69
3s	1948-46	(June 15)	0.82	4.94
3-1/8s	1949-46	(June 15)	0.84	4.94
4-1/4s	1952-47	(Oct. 15)	1.07	6.28
2s	1947	(Dec. 15)	.94	6.44
2s	1950-48	Mach. (T)	1.45	6.69
2-3/4s	1951-48	(March 15)	1.17	6.69
2-1/2s	1948	(Sept. 15)	1.11	7.19
2s	1950-48	(Dec. 15)	1.08	7.44
3-1/8s	1952-49	(Dec. 15)	1.43	8.44
2-1/2s	1953-49	(Dec. 15)	1.46	8.44
2-1/2s	1952-50	(Sept. 15)	1.51	9.19
2-3/4s	1954-51	(June 15)	1.60	9.94
3s	1955-51	(Sept. 15)	1.59	10.19
2-1/4s	1953-51	(Dec. 15)	1.55	10.44
2-1/2s	1954-52	(T) (March 15)	1.94	10.69
2s	1955-53	(June 15)	1.54(1)	11.94
2-1/4s	1956-54	(June 15)	1.65	12.94
2-7/8s	1960-55	(March 15)	1.89	13.69
2-1/2s	1958-56	(T.) (March 15)	2.16	14.69
2-3/4s	1959-56	(Sept. 15)	1.91	15.19
2-3/4s	1963-58	(June 15)	1.98	16.94
2-3/4s	1965-60	(Dec. 15)	2.02	19.44

(T) Subject to Federal Income Tax.
(1) Reported as 0.54, apparently typographical error.

MKT 7-9-41
L1

[fol. 10802]

United States Treasury Notes
Yield and Years to Call Date

(Based on Data in July 6, 1941 New York Times)

Issue	Rate	Yield	Years to Call Date
Dec. 1941	1-1/4%		0.44
March 1942	1-3/4		0.69
Sept. 1942	2		1.19
Dec. 1942	1-3/4	0.04	1.44
March 1943	3/4	0.04	1.69
June 1943	1-1/8	0.06	1.94
Sept. 1943	1	0.08	2.19
Dec. 1943	1-1/8	0.13	2.44
March 1944	1	0.25	2.69
June 1944	3/4	0.32	2.94
Sept. 1944	1	0.32	3.19
Sept. 1944 (T)	3/4	0.62	3.19
March 1945	3/4	0.41	3.69
Dec. 1945 (T)	3/4	0.69	4.44

(T) Subject to Federal Income Tax.

MKT 7-9-41
L2

PART

BOND SALES ON THE STOCK EXCHANGE

SATURDAY, JULY 5, 1941

	U. S. Govt.	Domestic.	Foreign.	Total All.
Daily sales	$8,400	$2,2[illegible]9,200	$156,000	$2,4[illegible]
Friday	22,550	6,751,200	475,600	7,249,550
Year to date	$9,805,775	$1,029,871,600	$81,821,100	$1,121,498,475
1940	26,032,500	712,340,000	124,115,000	862,487,500

UNITED STATES GOVERNMENT BONDS

1941 Range High.	1941 Range Low.	Sales in 1000s	Issue.	High	Low	Last.	Net Change.	Stock Excge. 3 P. M. Closing Bid.	Stock Excge. 3 P. M. Closing Asked.	Yield to Call Date.	Dealers' 4 P. M. Closing Bid.	Dealers' 4 P. M. Closing Asked.
102.19	101.21	..	Treasury 3¼s 1941				..	100.6	....	*	100.6	....
107.25	106.12		Treasury 3⅜s 1947-43				..	106.7	106.10	.12	106.6	106.8
108.6	106.26	1	Treasury 3¼s 1945-43	106.27	106.27	106.27	..	106.27	106.30	.19	106.27	106.29
109.9	107.29	1	Treasury 3¼s 1946-44	107.31	107.31	107.31	— 2	107.31	108.2	.33	108.00	108.2
109.4	109.4	1½	Treasury 3¼s 1946-44 reg.	107.28	107.28	107.28	Odd	....	....	....	....	....
11[illegible].18	111.19	1⅞	Treasury 4s 1954-44	111.21	111.21	111.21	Odd	111.21	111.24	.58	111.22	111.24
109.24	108		Treasury 2¾s 1947-45	....	....	....	..	108.16	108.19	.67	108.16	108.18
108.14	107.22	..	Treasury 2½s 1945	....	....	....	..	108.3	108.6	.63*	108.4	108.6
115.7	11[illegible].3	..	Treasury 3¾s 1956-46	....	....	....	..	113.4	113.7	.87	113.4	113.6
111.21	109.24	..	Treasury 3s 1948-46	....	....	....	..	110.15	110.18	.82	110.16	110.18
112.12	110.11	..	Treasury 3⅛s 1949-46	....	....	....	..	110.31	111.2	.84	110.31	111.1
121.26	119.4	..	Treasury 4¼s 1952-47	....	....	....	..	119.3	119.6	1.07	119.3	119.5
106.28	104.28	..	Treasury 2s 1947	....	....	....	..	106.15	106.18	.94*	106.17	106.19
103.2	[illegible].24	..	Treasury 2s 1950-48 March ......(T)	....	....	....	..	103.13	103.16	1.45	103.15	103.17
110.9	107.27	..	Treasury 2¾s 1951-48	....	....	....	..	109.31	110.2	1.17	110.1	110.3
[illegible].22	107.16	..	Treasury 2½s 1948	....	....	....	..	109.16	109.19	1.11*	109.17	109.19
[illegible].8	104.12	..	Treasury 2s 1950-48	....	....	....	..	106.16	106.19	1.08	106.17	106.19
114.9	112.15	..	Treasury 3⅛s 1952-49	....	....	....	..	113.12	113.15	1.43	113.14	113.16
108.1	105.2	..	Treasury 2½s 1953-49	....	....	....	..	108.4	108.7	1.46	108.6	108.8
108.8	105.4	..	Treasury 2½s 1952-50	....	....	....	..	108.12	108.15	1.31	108.14	108.16
110.14	10[illegible].2	2	Treasury 2¾s 1954-51	110.14	110.14	110.14	+ 1	110.14	110.17	1.60	110.16	110.18
113.6	[illegible]	..	Treasury 3s 1955-51	....	....	....	..	113.5	113.8	1.59	113.8	113.10
106.19	10[illegible].5	..	Treasury 2¼s 1953-51	....	....	....	..	106.20	106.23	1.55	106.21	106.23
105.9	[illegible]	..	Treasury 2½s 1954-52 ......(T)	....	....	....	..	105.11	105.14	1.94	105.12	105.14
105.[illegible]	10[illegible].24	..	Treasury 2s 1955-53	....	....	....	..	104.29	105.1	.54	104.30	105.00
106.26	10[illegible].5	..	Treasury 2¾s 1956-54	....	....	....	..	106.28	106.31	1.65	106.29	106.31
111.24	107.14	..	Treasury 2⅞s 1960-55	....	....	....	..	111.19	111.22	1.89	111.21	111.23
104.2	103.1	..	Treasury 2½s 1958-56 ......(T)	....	....	....	..	104.6	104.8	2.16	104.6	104.8
111	107.1	..	Treasury 2¾s 1959-56	....	....	....	..	110.30	111.1	1.91	110.31	111.1
110.31	106.31	..	Treasury 2¾s 1963-58	....	....	....	..	110.31	111.2	1.98	111.1	111.3
111.22	107.8	1	Treasury 2¾s 1965-60	111.20	111.20	111.20	+ 4	111.17	111.20	2.02	111.17	111.19
101.3	101.28	..	Federal Farm Mtge. 3s 1947-42	....	....	....	..	101.28	101.31	..	101.29	102.00
104	102.15	..	Federal Farm Mtge. 2¾s 1947-42	....	....	....	..	101.28	101.31		101.29	102.00
107.28	106.26	..	Federal Farm Mtge. 3¼s 1964-44	....	....	....	..	107	107.3	.57	107.1	107.3
108	106.28	..	Federal Farm Mtge. 3s 1949-44	....	....	....	..	107.4	107.6	.47	107.4	107.6
103	102.5	..	Home Owners Loan 2¼s 1944-42	....	....	....	..	102.4	102.6		102.5	102.7
107.26	106.17	..	Home Owners Loan 3s 1952-44	....	....	....	..	105.24	106.26	.57	106.24	106.26
103.2	101.29	..	Home Owners Loan 1½s 1947-45	....	....	....	..	102.23	102.25	.77	102.23	102.25

*Yield to maturity. Quotations after decimals in the above table represent 32ds of a point. T Subject to Federal taxes.

U. S. GOVERNMENT A

TREASURY NOTES

Outstanding Millions.			Rate.	Bid.	Asked.	Yield.
204	Dec.,	'41	1¼	101.29	101.31	..
426	Mar.,	'42	1⅛	102.9	102.11	..
342	Sept.,	'42	2	103.12	103.14	..
232	Dec.,	'42	1¾	103.5	103.7	..
66§	Mar.,	'43	¾	101.3	101.6	0.04
629	June,	'43	1⅛	102.1	102.3	0.04
279	Sept.,	'43	1	101.30	102	0.08
421	Dec.,	'43	1⅛	102.11	102.13	0.13
515	Mar.,	'44	1	101.30	102	0.25
416	June,	'44	¾	101.6	101.8	0.32
283	Sept.,	'44	1	102.2	102.5	0.32
635§	Sept.,	'44	¾	100.10	100.12	0.62
718	Mar.,	'45	¾	101.5	101.7	0.41
531§	Dec.,	'45	¾	100.5	100.7	0.69

§Subject to Federal taxes.

TREASURY BILLS

(Subject to Federal taxes)

For discount at purchase:

	Bid.	Asked.
400 July 9-16-23-30...	0.13%	....
400 Aug. 6-13-20-27...	0.13%	....
700 Sept. 3-10-17-24...	0.13%	....
100 Oct. 1...........	0.13%	....

INSULAR BONDS

	Rate.	Date.	Bid.	Ask.
Hawaii	4½	Oct., 1956-46	115	116½
Philippines	4½	July, 1957	107	109½
Philippines	4½	Oct., 1959	107½	110½
Philippines	4½	July, 1952	107	109
Philippines	5	Feb., 1952	109	112
Philippines	5½	Aug., 1941	100½	100⅝
Puerto Rico......	4½	Jan., 1956	122	124¼
Puerto Rico......	5	July, 1948-43	106½	107⅝

6, 1941.

GOVERNMENT AND AGENCY BONDS

[illegible]EASURY NOTES

	Rate.	Bid.	Asked.	Yield.
'41	1¼	101.29	101.31	..
'42	1¾	102.9	102.11	..
'42	2	103.12	103.14	..
'42	1¾	103.5	103.7	..
'43	¾	101.3	101.6	0.04
'43	1⅛	102.1	102.3	0.04
'43	1	101.30	102	0.08
'43	1⅛	102.11	102.13	0.13
'44	1	101.30	102	0.25
'44	¾	101.6	101.8	0.32
'44	1	102.2	102.5	0.32
'44	¾	100.10	100.12	0.62
'45	¾	101.5	101.7	0.41
'45	¾	100.5	100.7	0.69

t to Federal taxes.

[illegible]EASURY BILLS

[illegible]ct to Federal taxes)
[illegible]ount at purchase:

	Bid.	Asked.
9-16-23-30	0.13%	....
6-13-20-27	0.13%	....
3-10-17-24	0.13%	....
1	0.13%	....

[illegible]SULAR BONDS

Rate.	Date.	Bid.	Ask.
4½	Oct., 1958-44	115	116½
4½	July, 1957	107	109½
4½	Oct., 1959	107½	110¼
4½	July, 1952	107	109
5	Feb., 1952	109	112
5½	Aug., 1941	100½	100¾
4½	Jan., 1956	122	124¼
5	July, 1948-43	106½	107¾

U. S. BONDS

	Bid.	Asked.
Panama 3s, 1961	125	128
Conversion 3s, 1947	112	112¾
Conversion 3s, 1946	110⅝	111

FEDERAL LAND BANK BONDS

	Bid	Asked	Yld.
4s, July, 1946-44	110¼	110½	0 15
4s, July, 1944-44	109⅞	110⅛	0 57
3¼s, May, 1955-45	109	109	0 74
3s, July, 1955-45	108¾	108¾	0 78
3s, Jan., 1956-46	109¾	109¾	0 79
3s, May, 1956-46	110	110¼	0 83

FEDERAL HOME LOAN BANKS

Outst'g Millions	Rate				
32	¾	Apr. 15, 1942	100 8	100 11	0 31
23.5	2	Apr. 1, 1943	102 20	102 24	0.41

RECONSTRUCTION FINANCE

299	⅞	Nov. 1, 1941	100 21	100 23	..
310	⅞	Jan. 15, 1942	100 20	100 22	..
276	1	July 1, 1942	101	101 2	..
320	⅞	Oct 15, 1942	100 22	100.24	0 29
344	¹1⅛	July 15, 1943	101 2	101 4	0 56
573	¹1	Apr 15, 1944	100.21	100.23	0 78

1 Subject to Federal taxes.

FEDERAL NAT. MORTG. ASSN.

29	2	May 16, '43-41	101 11	101 14	
55	1⅝	Jan 3, '44-42	101 21	101 24	0.09

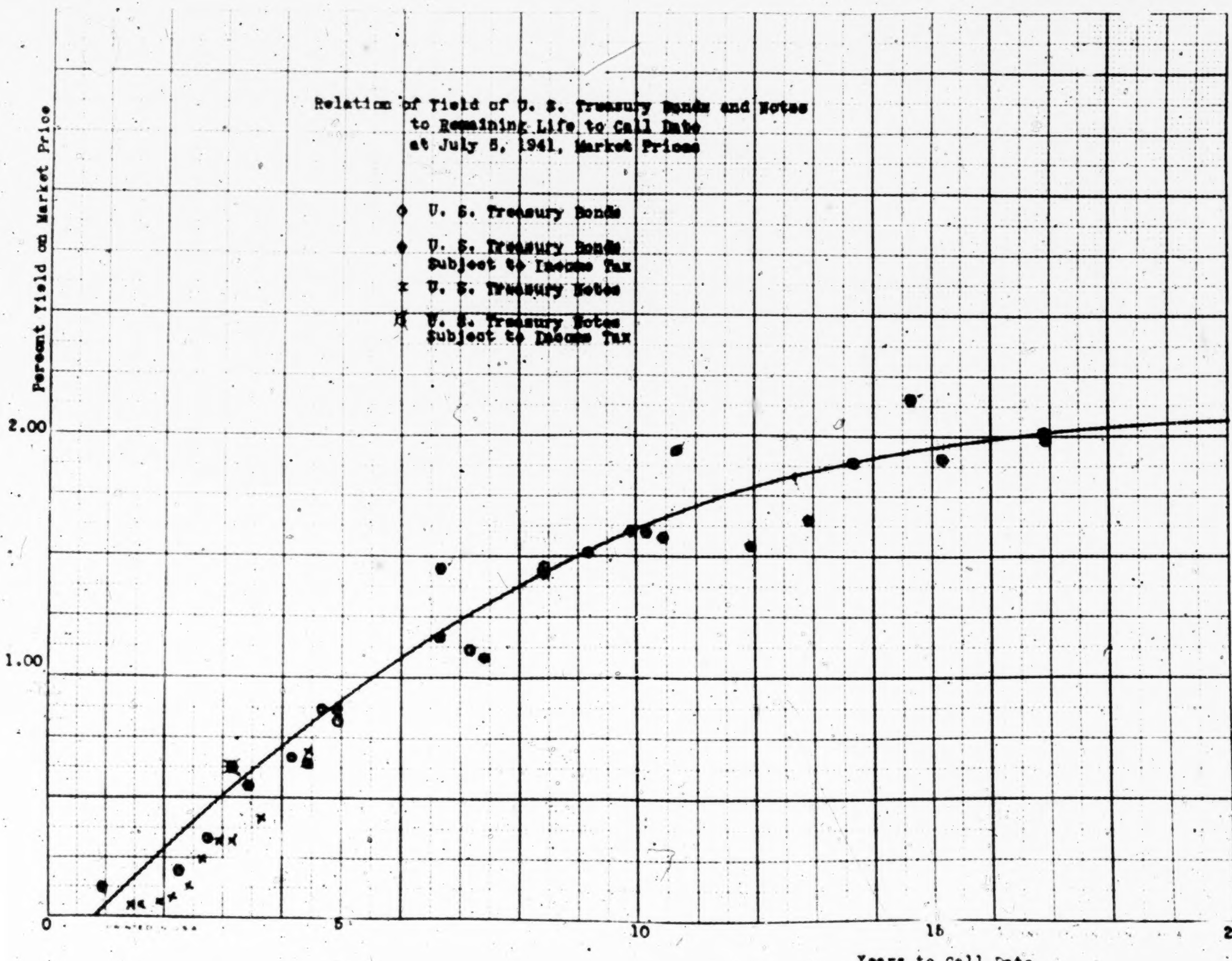
COMMODITY CREDIT CORP.

203	⅝	Aug 1, 1941	100.17	100 19	..
204	1	Nov 15, 1941	100 21	100 23	
289	⅝	May 1, 1943	100 27	100 29	0 25

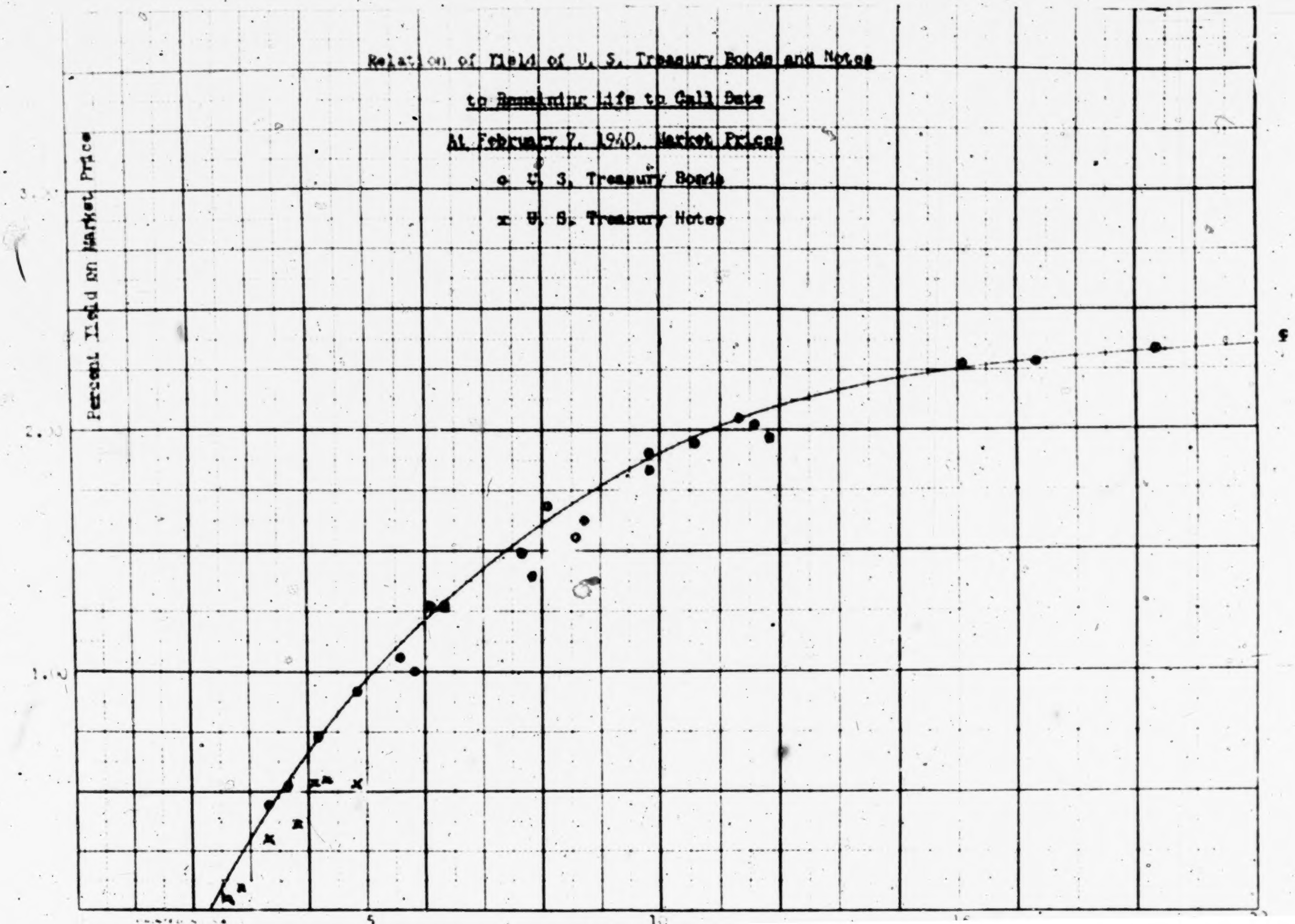
U. S. HOUSING AUTHORITY

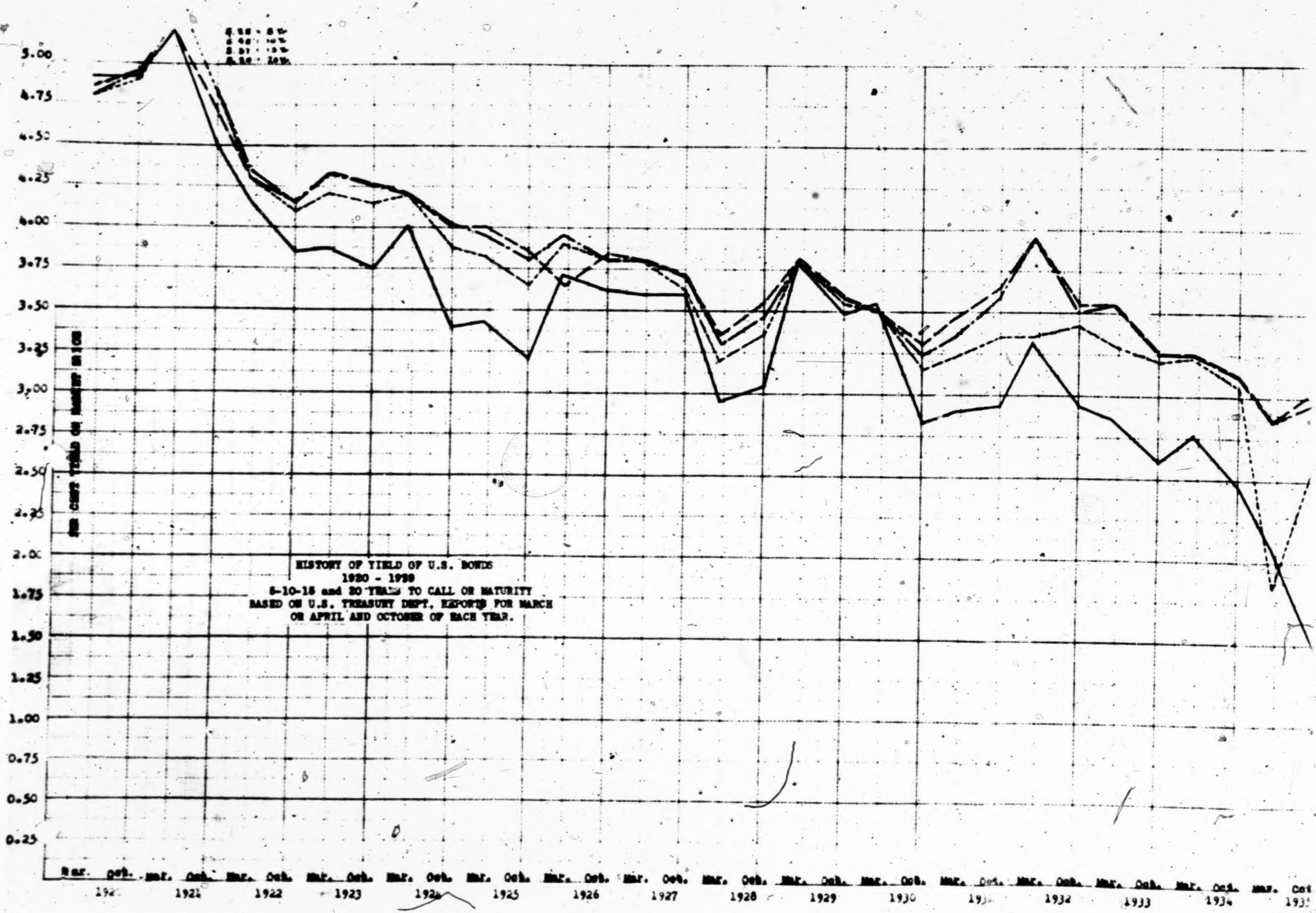
112	¼	Nov. 1, 1941	100	100 2	0 05
114	1⅜	Feb. 1, 1944	102 12	102 14	0 43

PART OF EXHIBIT 12.



PART OF EXHIBIT 12.




HISTORY OF YIELD OF U.S. BONDS
1920 - 1939
5-10-15 and 20 YEARS TO CALL OR MATURITY
BASED ON U.S. TREASURY DEPT. REPORTS FOR MARCH
OR APRIL AND OCTOBER OF EACH YEAR.
5.00
4.75
4.50
4.25
4.00
3.75
3.50
3.25
3.00
2.75
2.50
2.25
2.00
1.75
1.50
1.25
1.00
0.75
0.50
0.25
Mar. Oct. Mar. Oct. Mar. Oct. Mar. Oct. Mar. Oct. Mar. Oct. Mar. Oct. Mar. Oct. Mar. Oct. Mar. Oct. Mar. Oct. Mar. Oct. Mar. Oct. Mar. Oct. Mar. Oct. Mar. Oct.
1921
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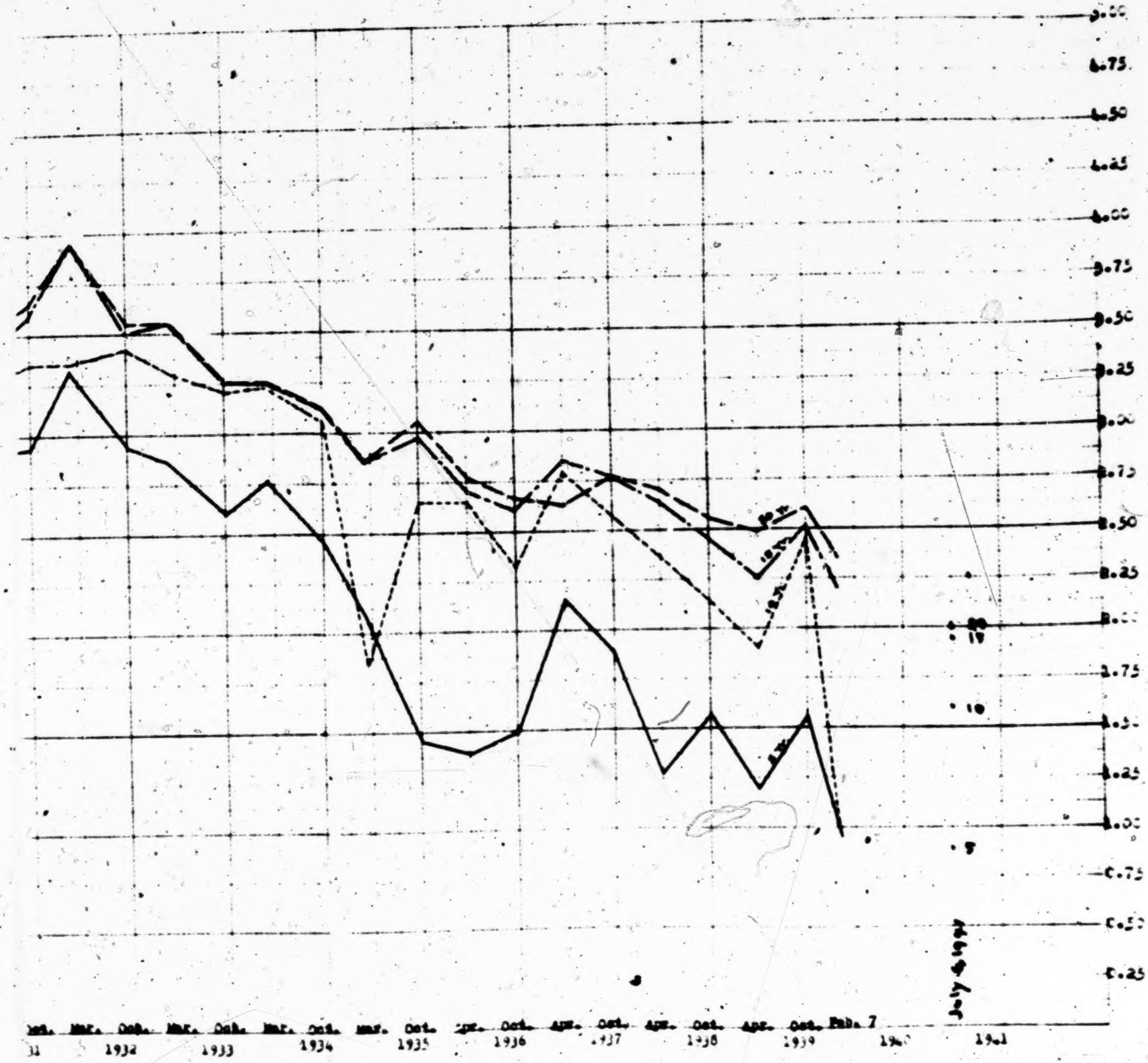
1932
1933
1934

EXHIBIT 13.



[fol. 10807]

Exhibit 14

Average Yield of Annually Maturing Investment with Yield of Each Maturity Equal to the Yield of U. S. Treasury Bonds or Notes of Equal Maturity

(Equal Annual Maturities)

Life years	Percent yield (1)	Life years	Percent yield (1)	Life years	Percent yield (1)
1	0.05	11	1.708	21	2.075
2	0.285	12	1.785	22	2.088
3	0.502	13	1.85	23	2.10
4	0.710	14	1.91	24	2.112
5	0.780	15	1.95	25	2.125
6	1.075	16	1.988	26	2.137
7	1.235	17	2.013	27	2.150
8	1.375	18	2.038	28	2.162
9	1.500	19	2.05	29	2.175
10	1.613	20	2.063	30	2.178
			Total		49.782
			Average		1.66

(1) Interpolation and exterpolation from July 6, 1941 yields of various issues of U. S. Treasury Bonds and Notes. Exterpolation also guided by consideration of yield records since 1920.

MKT 7-11-41

O

[fol. 10808] (Exhibit 14-A.)

For Release in Morning Newspapers of Wednesday, May 28, 1941.

Securities and Exchange Commission
Washington, D. C.

Holding Company Act

Release No. 2778

In the Matters of

Panhandle Eastern Pipe Line Company,

File Nos. 31-109, 31-493, 31-108

Columbia Oil & Gasoline Corporation,

File Nos. 31-107, 31-106

Columbia Gas & Electric Corporation,

File Nos. 31-422, 31-423

Public Utility Holding Company Act of 1935—Section 2(a) (8)

Findings and Opinion of the Commission.

Declaration of Status

Subsidiary Company

Applications filed pursuant to Section 2(a) (8) of the Act requesting orders declaring companies not to be subsidiary companies of specified holding companies owning more than 10 percent of applicants' outstanding voting securities, denied in part upon applicants' failure to show that their management and policies are not subject to a controlling influence by such holding companies within the meaning of Section 2(a) (8) of the Act, and granted conditionally insofar as it appears that one of such holding companies did not exercise such control or controlling influence over one of applicants.

Appearances:

William L. Glenn and Edward N. Goodwin for Panhandle Eastern Pipe Line Company.

Douglas M. Moffat and William Wemple, of Cravath, deGersdorff, Swaine & Wood, for Columbia Gas & Electric Corporation.

William H. Button and James B. Alley, for Columbia Oil & Gasoline Corporation.

[fol. 10800] Robert J. Bulkley, Richard B. Hand, and Arthur G. Logan, for Missouri-Kansas Pipe Line Company.

Kenneth L. Sater, Assistant Attorney General, for the Public Utilities Commission of Ohio.

James H. Lee, for the City of Detroit.

Ambrose Selig and John Houser, for the Public Utilities Division of the Commission.

This proceeding arises out of a series of applications involving the status, under the Public Utility Holding

Company Act of 1935, of Columbia Oil & Gasoline Corporation and Panhandle Eastern Pipe Line Company. Both of these companies have filed applications under Section 2(a) (8) of the Act for orders declaring them not to be subsidiaries of Columbia Gas & Electric Corporation.[1] Columbia Gas & Electric Corporation, a registered holding company, has applied for orders declaring that neither of these companies is its subsidiary.[2]

The application of Panhandle Eastern Pipe Line Company, in addition, requests orders declaring it not to be a subsidiary of Columbia Oil & Gasoline Corporation or Missouri-Kansas Pipe Line Company.[3]

Panhandle Eastern has also applied for an order declaring it not to be a gas utility company within the meaning of Section 2(a) (4) of the Act,[4] and Columbia Oil has requested exemption for itself and its subsidiaries pursuant to Section 3(a) (3) of the Act.

[fol. 10810] On February 13, 1941, we ordered the hearings upon these applications consolidated.[5] We permitted intervention by the City of Detroit, and, because of an interest which will subsequently be commented upon, we permitted Mokan to participate in the proceeding to the extent of cross-examining witnesses, adducing evidence, filing briefs and presenting oral argument on matters involving Panhandle Eastern.

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[1]The Columbia Oil & Gasoline Corporation application was finally amended on March 28, 1941, (File No. 31-107). The Panhandle Eastern Pipe Line Company application was finally amended on December 3, 1940, (File No. 31-109).

[2]These applications dated April 7, 1938, relate also to certain subsidiaries of both Columbia Oil & Gasoline Corporation and Panhandle Eastern Pipe Line Company (Files No. 31-422, 31-423).

[3]In the course of this opinion the various companies involved will be referred to as follows:

Panhandle Eastern Pipe Line Company—Panhandle Eastern
Columbia Oil & Gasoline Corporation—Columbia Oil
Columbia Gas & Electric Corporation—Columbia Gas
Missouri-Kansas Pipe Line Company—Mokan
Michigan Gas Transmission Corporation—Michigan Gas

All of these companies are Delaware corporations.

[4]File No. 31-108. The latest amendment to this application occurred on February 1, 1941.

[5]Holding Company Act Release No. 2554, February 13, 1941.

After due notice a hearing was held. After conference before us between counsel involved, counsel agreed to forego a trial examiner's report. Requests for findings and briefs were filed and we heard argument.

In our order of February 13, 1941, we provided for consolidation of the hearings with respect to all the applications noted above. This order expressly reserved our right, "if at any time it may appear conducive to an orderly and economic disposition of either proceeding, to order a separate hearing concerning either matter, to close the record with respect to either matter, or to take action on either matter prior to closing the record on said other matter." Thus far, the issues presented under Section 2(a) (8) have completely absorbed the attention of all parties to the proceeding. It has been suggested that it would be highly desirable to have our decision on the questions under Section 2(a) (8) at the earliest possible date; and we have been requested by counsel for the Public Utilities Division to defer consideration of the applications under Sections 2(a) (4) and 3(a) (3) until the staff shall have had more time to study and appraise them and prepare any further presentation of evidence or argument which may seem appropriate. We think it conducive to an orderly and economic disposition of this proceeding to grant this request; and we shall decide here only the questions arising under the Section 2(a) (8) applications. We expect, of course, that immediate steps will be taken for study of the problems presented in the Sections 2(a) (4) and 3(a) (3) applications with a view to their speedy determination.

The Applicants

Panhandle Eastern is a company engaged in the production, transmission and sale of natural gas. It taps fields in Texas and Kansas, and its lines run through Texas, Oklahoma, Kansas, Missouri and Illinois. It has outstanding:

$12,000,000 Series B 3% bonds due November 1, 1960

$6,250,000 Series A 6% bonds due serially November 1, 1946 to November 1, 1950

$5,000,000 of notes due serially November 1, 1942 to November 1, 1945

[fol. 10811]

Class A, $100 par preferred stock,* $6 cumulative, participating	100,000 shares
Class B, $100 par preferred stock, * $6 cumulative, non-participating	10,000 shares
Common stock, no-par	807,367 shares

* (Class A stock is redeemable, Class B is not)

All of Panhandle Eastern's preferred stock is held beneficially[6] for Columbia Oil, and Columbia Oil owns beneficially 404,326 shares, or 50.1% of Panhandle Eastern's common stock. 339,475 shares, or 42.0% of the common stock, is owned by Mokan. The remaining 7.9% is in the hands of over 1,700 holders. The bonds of Panhandle Eastern (many of which are bearer bonds) are stated to be held by interests unaffiliated with the Columbia companies.

All classes of Panhandle Eastern's stock vote share for share except in the election of directors. In such elections the Class A preferred has no vote; the Class B preferred as a class has the right to elect two out of a total of nine directors; and the common stock as a class, with the privilege of voting cumulatively, has the right to elect the other seven. Thus, subject to considerations to be discussed further on in this opinion, Columbia Oil has a substantial voice in Panhandle Eastern's affairs and is empowered to select a majority of its board.

Columbia Oil was formed by Columbia Gas in 1930 to acquire the securities of oil and gasoline subsidiaries of Columbia Gas. It has outstanding the following securities:

6% debentures due 1956	$21,000,000 principal amount
Preferred stock, participating	400,000 shares
Common stock, $1 par	2,336,826 shares

[6]The manner and occasion for this holding will be discussed subsequently

Columbia Gas holds all the preferred stock, which has full voting rights, and may elect the largest minority of the Columbia Oil board. Columbia Gas also holds all of the outstanding debentures. It holds none of the common stock. This stock, issued to Columbia Gas on the formation of Columbia Oil in 1930, was in the same year placed in a voting trust. The voting trust certificates were, in that year, distributed to the holders of Columbia Gas common stock as a dividend. The identity of record common stock ownership of Columbia Oil and Columbia Gas which existed by virtue of this distribution has decreased from the original 100% to about 72%. The voting trustees of this trust were at all times persons presently or previously connected with the Columbia Gas management. The trust was terminated on May 28, 1936, and the stock distributed to the beneficial owners.

[fol. 10812] Columbia Oil and Panhandle Eastern are thus subsidiaries of Columbia Gas, and Panhandle Eastern is a subsidiary of Columbia Oil under Section 2(a) (8). It is contended, however, that there is no chain of control or controlling influence making it necessary to subject either Columbia Oil or Panhandle Eastern to the requirements of the Act applicable to subsidiaries of registered holding companies.[7]

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[7]Section 2(a) (8) defines the term " 'subsidiary company' of a specified holding company" to mean "any company 10 per centum or more of the outstanding voting securities of which are directly or indirectly owned, controlled, or held with power to vote, by such holding company (or by a company that is a subsidiary company of such holding company by virtue of this clause or clause (B)), unless the Commission, as hereinafter provided, by order declares such company not to be a subsidiary company of such holding company;"

Upon application, the Commission may declare that a company is not a subsidiary company of a specified holding company only if it finds that:

"'(i) the applicant is not controlled, directly or indirectly, by such holding company (either alone or pursuant to an arrangement or understanding with one or more other persons) either through one or more intermediary persons or by any means or device whatsoever, (ii) the applicant is not an intermediary company through which such control of another company is exercised, and (iii) the management or policies of the applicant are not subject to a controlling influence, directly or indirectly, by such holding company (either alone or pursuant to an arrangement or understanding with one or more other persons) so as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that the applicant be subject to the obligations, duties and liabilities imposed in this title upon subsidiary companies of holding companies."

The Relationship Between Columbia Oil and Columbia Gas

Columbia Oil was used as a vehicle by Columbia Gas for investment in Panhandle Eastern, and Columbia Gas has been the sole source of capital for this investment.[8] [fol. 10813] We shall note later the effect of this investment on the affairs of Columbia Oil and Panhandle Eastern, for out of it Columbia Gas expected "a certain flow

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[8] Columbia Oil's investment in Panhandle Eastern began in 1930. On September 17, 1930, Mokan, which then owned all of the common stock of Panhandle Eastern, sold 50% of that stock to Columbia Oil. Mokan then transferred the remaining half of Panhandle Eastern's stock to Panhandle Corporation, all of whose securities Mokan held. Mokan, which had issued notes for over $1,000,000 with 90% of Panhandle Corporation's stock pledged as security, lost 75% of that stock in 1933. This stock was subsequently on February 6, 1936, acquired by Columbia Oil which also acquired all of Panhandle Corporation's indebtedness.

On October 23, 1930, Columbia Oil purchased from the National City Bank Panhandle Eastern's first mortgage bonds in the principal amount of $20,000,000.

Early in 1931 Panhandle Eastern received capital from Columbia Oil for pipe line construction in the amount of $4,945,500 in exchange for which it issued to Columbia Oil that amount in 6% notes and 109,900 shares of its common stock. Mokan through Panhandle Corporation made an equal capital contribution and took an equal amount of notes and stock.

Columbia Gas, in order to enable Columbia Oil to invest in Panhandle Eastern, had advanced to it, by the end of 1935, $32,232,652.24. Columbia Oil in return gave its notes, secured by the pledge of the Panhandle Eastern's securities received by it. Columbia Gas also advanced to Columbia Oil $1,882,071.75 for investment in the securities of Indiana Gas Transmission Corporation in exchange for Columbia Oil 6% notes. On February 28, 1936, in a transaction which we shall subsequently discuss, Columbia Oil surrendered the securities of Indiana Gas to Columbia Gas in exchange for its notes secured by those securities.

In 1936 Columbia Oil transferred to Columbia Gas $14,574,500 of Panhandle Eastern mortgage bonds and in exchange Columbia Gas cancelled that amount of Columbia Oil's indebtedness to it. Columbia Gas sold these bonds to several insurance companies in July of 1936, at a profit of $722,895.

The present round figure of $21,000,000 of Columbia Oil debt held by Columbia Gas is accounted for by Columbia Gas' purchase of an additional $3,342,000 of debentures, $2,000,000 of which was used by Columbia Oil for the purchase of 80,000 additional shares of Panhandle Eastern common stock.

Between 1936 and 1939 the holdings of Mokan and Columbia Oil in the common stock of Panhandle Eastern were equalized. The present unequal division of the common stock between these companies results from the distribution by Mokan to its stockholders, in 1939, of a block of warrants for 80,000 shares. This transaction will be discussed further on in this opinion.

of earnings," and assurance of "future voting rights." Columbia Oil, although it is merely a means of administering assets placed in its hands by Columbia Gas nevertheless claims independence from that company.

There has been no serious attempt to negative the existence of control of Columbia Gas over Columbia Oil prior to June 7, 1934. The positions of officers and directors of both companies were concededly interlocking. It is asserted, however, that a reorganization of the relationships of these companies has resulted in a severance of control.

[fol. 10814] 1. The first step of severance is claimed to have occurred on June 7, 1934.[9] On that day with one exception, all persons who were officers or directors of Columbia Gas resigned their positions in Columbia Oil, and one, who held positions with both Columbia companies, resigned from Columbia Gas. Messrs. Harrop, Watkins, Philips and Munroe constituted the new Columbia Oil board.

The background of these new directors is significant. Harrop, it was asserted, had no prior connection with Columbia Gas. However, he joined the board of Columbia Oil at the invitation of Munroe who had been a Director and Vice-President of Columbia Gas and was a voting trustee for the Columbia Oil common stock.[10] Watkins had served with Panhandle Eastern as Assistant Secretary and Treasurer from 1931 to 1934. He had also been connected with various other Columbia Gas subsidiaries until 1932. Philips had been a director of Columbia Gas from 1926 to 1930. Munroe's affiliations have been stated.[11]

2. The next steps toward severance are alleged to have occurred as a result of a government suit for violation of the anti-trust laws.

[9] It appears that at about this time Columbia Gas may have had some intimation of the imminence of an anti-trust suit and that this knowledge was one of the principal reasons for the changes in personnel and affiliations. The anti-trust suit will be discussed subsequently.

[10] Munroe resigned his connections with Columbia Gas on June 7, 1934.

[11] Messrs. W. A. Blind and C. A. Lavin were elected Assistant Secretaries of Columbia Oil at the June 7, 1934, meeting. Both had been, up to that time, in the personal employ of Munroe.

A. The Anti-Trust Suits

In March of 1935 the United States filed a petition naming as defendants Columbia Gas, Columbia Oil, G. H. Howard, P. G. Gossler, C. A. Munroe, T. B. Gregory, Edward Reynolds, Jr., Burt R. Bay and J. H. Hillman, Jr. The petition alleged domination of Panhandle Eastern by the defendants for the purpose of preventing it from competing with Columbia Gas. It requested an injunction against such domination and the divestiture of ownership by Columbia Oil of Panhandle Eastern securities.

In July of 1935 an action for treble damages was brought against the same defendants named in the government suit by H. T. Bush and C. Ray Phillips, receivers for Mokan, on allegations substantially similar to those made in the government suit. On January 29, 1936—a critical date in these proceedings, a stipulation was entered into between the United States and the defendants in its suit, and a consent decree was entered upon that stipulation. The applicants rely upon the operation of this decree for their claim that the current of control between them has been insulated.

[fol. 10815] B. The Terms of the Stipulation and Decree

The stipulation contained, among others, undertakings for:

1. A financial reorganization of Columbia Oil to effect partial liquidation of Columbia Oil's debt to Columbia Gas, conversion of the remainder into at least fifteen year obligations to be held by Columbia Gas, and conversion of the then outstanding classes of Columbia Oil's preferred stock into one class—to be held by Columbia Gas, and pursuant to which Columbia Gas might elect the largest minority of the Columbia Oil board.[12]

2. Assurance that the officers, and the majority of Columbia Oil directors were not to be officers, directors or employees of Columbia Gas.

[12]Columbia Oil was, prior to the time of the decree, in heavy default on its notes and in arrears of $22,000,000 in dividends on its preferred stock. Columbia Gas was, therefore, in a position to assert an immediate claim on the assets of Columbia Oil.

3. Dissolution of the voting trust with respect to Columbia Oil common stock, and granting to that stock cumulative voting rights.

4. Permission to Panhandle Eastern to make final commitments to carry out a contract which it had made with the Detroit City Gas Company to supply gas to Detroit,—a point east of the then terminus of its lines.

5. An offer of settlement to be made by Columbia Oil to the Mokan receivers, with respect to the claim made by Mokan against the Columbia companies, which settlement would permit Mokan to acquire one-half of Panhandle Eastern's common stock, subject to conversion rights of any preferred which Panhandle Eastern might issue, and "other conditions" of the offer which might "alter the proportionate interest of the various parties" in Panhandle Eastern.

The decree enjoins, in broad language, the exercise of domination or control of Panhandle Eastern, interference with its free action in the natural gas business, and exercising any influence over it, and it further purports to enjoin the defendants from ". . . holding, acquiring, voting or in any manner acting as the owners, directly or indirectly, of the whole or any part of the stock or other share capital, or bonds" of Panhandle Eastern or any company owning a substantial amount of Panhandle Eastern securities or assets of Panhandle Eastern.

Notwithstanding the foregoing provisions, the decree expressly permits:

[fol. 10816] 1. The defendants to own stock and bonds of Columbia Gas and Columbia Oil, and to act as officers and directors thereof;

2. Columbia Gas to acquire obligations with no present or potential voting rights, of Panhandle Eastern, (although it interdicts acquisition of Panhandle Eastern's physical assets by enforcing the obligations);

3. Columbia Oil to own and acquire stock or bonds of Panhandle Eastern and vote Panhandle Eastern's securities in accordance with the decree.